

THE ADVISORY COMMITTEE
ON SUCCESSION DUTIES
REPORT
FEBRUARY 23, 1973

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THE ADVISORY COMMITTEE
ON SUCCESSION DUTIES

REPORT

FEBRUARY 23, 1973

INTRODUCTION

On June 6, 1972 the Minister of Revenue, the Honourable Allan Grossman issued an order naming the following persons to constitute the Advisory Committee on Succession Duties:

J. Alex Langford, Q.C., Chairman

Elmer D. Bell, Q.C.

G. Melvin Bird

J. Albert Brule, Q.C.

Wolfe D. Goodman, Q.C.

John Hodgson, Q.C.

R. Bredin Stapells, Q.C.

Frederick S. Mallett, C.A.

Garfield P. Smith, F.C.A.

Henry N.R. Jackman

Reginald L. Kayler, Q.C., C.L.U.

S. Sheldon Taerk, C.L.U.

A. John Cheney, C.A.

D. Lyall MacLachlan, B.Sc.

The following persons were ex officio members:

Derek W. Rowsell

Terence M. Russell, Ph.D.

Isaac Stephenson, C.G.A., Executive Director

The order established the following terms of reference:


- (A) Make a comprehensive review and thorough examination of the presently existing Succession Duty Act;
- (B) Enquire into and report to the Minister of Revenue upon the implication of the impact of succession duties on the family farm, family business and on Canadian versus foreign control of business;

- (C) Enquire into and report to the Minister of Revenue upon the relationship between succession duties and the present exemptions relevant to charitable, cultural, educational and religious organizations;
- (D) Consider and report to the Minister of Revenue a better means of raising from the death and gift tax fields an amount of revenue equal to the yield from current legislation;
- (E) Advise the Minister of Revenue on a revision of the present Succession Duty Act;
- (F) Examine and report to the Minister of Revenue upon the relationship between the administration of The Succession Duty Act and The Surrogate Courts Act with the objective of avoiding duplication of costs in the administration of related statutes;
- (G) Enquire into and report to the Minister of Revenue upon the implication of the impact of succession duties and gift taxes on the concentration of wealth in Ontario and the investment in Ontario resources;
- (H) Enquire into the effect on the maintenance of a health climate for continued growth in Ontario, by reason of the nature of intention of other provinces, to withdraw or remain out of The Succession Duty and Gift Tax fields.

(The Ministerial Order appears as Appendix A to this Report.)

At an early state the Committee considered the propriety and advisability of inviting and of receiving public briefs and submissions. We noted that for a number of years, the Canadian tax reform debate had given all and sundry an ample opportunity to air their views on death taxes as well as income taxes. We noted further that the Carter Report, the Smith Report, and the White Report had reported extensively upon the whole matter, after having given the public a full opportunity to be heard.

We thought that the membership of the Committee were acquainted with most of the positions that might be put to the Committee in public hearings. Further, the principal area in which



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the Committee might overlook viewpoints of value was the technical area from which the least help could be obtained from the public.

The government had approached us for practical advice in the context in which it was placed as a result of the federal abandonment of the gift and estate tax fields, coupled with the introduction of a tax on capital gains. If it had been minded to obtain a fundamental report to replace the reports above-mentioned, it would have appointed fewer people, and different people, and on a full time basis, with a larger budget with greater emphasis on research staff. In this context we came to the following procedural conclusions:

- (1) We would not announce public hearings or invite briefs generally.
- (2) However, in order to ensure that technical points were not overlooked, briefs should be requested from the bar, the life insurance industry, the trust companies and the valuation profession.
- (3) We would entertain and consider any submission made to us in writing, and would be prepared to consider an oral hearing if the subject-matter of the written submission made it clear that an oral presentation would be valuable to the Committee.

The Committee met in plenary meetings on eleven full days between June and February. In addition, subcommittees met on another sixteen days during the same period.

In that we meant the advice to be practical we kept in touch with the Minister of Revenue and his Deputy, and also the Comptroller of Revenue in order to be advised of changes in the context of our work, especially in connection with federal-provincial and interprovincial relations, and changing estimates of current succession duty, and capital gains yield. We heard submissions from the persons or groups listed in Appendix D to this report.

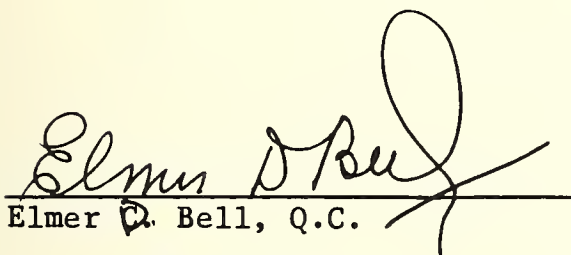
The report which follows is the report of all of us.

Unquestionably there are points which some of us would wish for a different emphasis in expression, or a different reason expressed for a recommended change, but after the fullest discussion all are now willing and satisfied to join in subscribing their names to the report which follows.

The members of the Committee wish to thank the Government of Ontario for this opportunity of serving their Province.



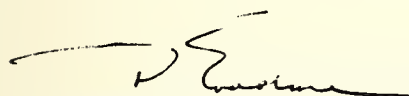
J. Alex Langford, Q.C., Chairman



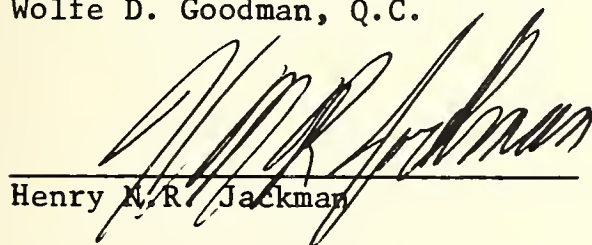
Elmer D. Bell, Q.C.



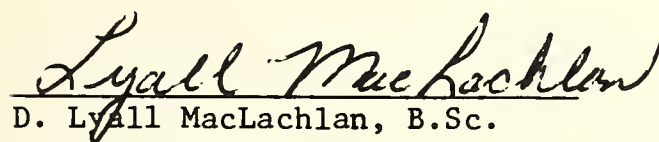
J. Albert Brule, Q.C.



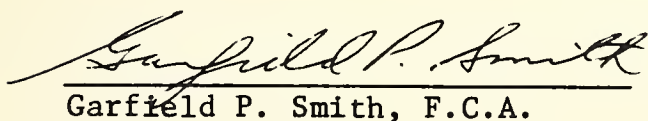
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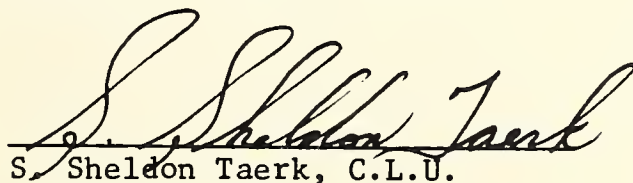
Henry N.R. Jackman



D. Lyall MacLachlan, B.Sc.



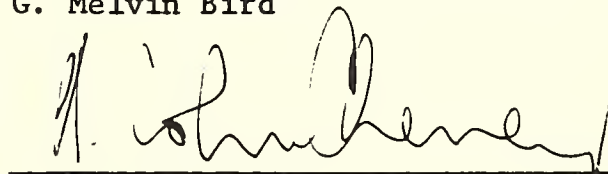
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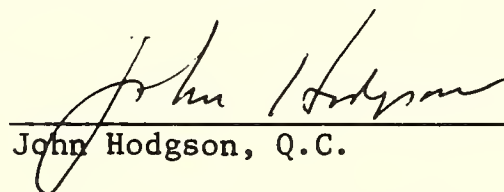
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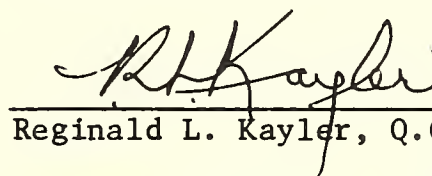
G. Melvin Bird



A. John Cheney, C.A.



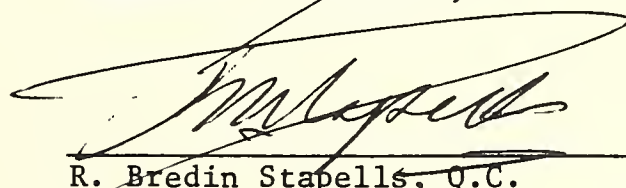
John Hodgson, Q.C.



Reginald L. Kayler, Q.C., C.L.U.



Frederick S. Mallett, C.A.



R. Bredin Stapells, Q.C.

Summary of the Report

Chapter I The Major Issues

The Committee believes that the question as to whether Ontario should continue to levy a succession duty is one which is more properly left to the Government to resolve.

We have framed our report on the assumption that the tax is to be retained at least for the time being. We emphasize however that this should not be construed as a recommendation that the Province should or should not continue the tax.

The imposition of an income tax on capital gains deemed to be realized at death can produce a double tax burden which in some cases is very severe. No completely satisfactory solution is available to the Province to overcome this double impact short of a complete withdrawal from the succession duty field. However, on the assumption that the Province will retain the tax at least for the time being, the Committee recommends that:

- The federal government be asked to amend the Income Tax Act to eliminate the deemed realization provisions at death. (page 10). Pending this,
- Ontario should exempt from duty capital gains and recaptured capital cost allowances subject to income tax at death. This could be accomplished by a tax credit described more fully in Chapter IX. (pages 12 - 14).

Chapter II The present statute

The present Succession Duty Act has been referred to as being the worst piece of tax legislation on the books of the Province. A thorough re-writing of the Act is therefore long overdue. The Committee condemns the Act for more serious offences. Substantial differences in tax result simply because of minor differences in the provisions in the will. The Succession Duty Act is also noted for the ease with which tax can be substantially reduced

or even eliminated by perfectly legal estate planning measures. The Committee concluded that:

- The Succession Duty Act should be repealed immediately and, if the government chooses to retain the tax, be replaced by a modern simplified death tax. (pages 15 - 17).

Chapter III Rates and Exemptions

The Committee recommends that the maximum tax rate should be reduced from 50% to 30%. (pages 18 - 20).

The Committee recommends either of two new and simpler methods of calculating rates. (Described in Chapter IX).

The Committee recommends a new list of exemptions, designed upon a new basis. (pages 23 - 31).

- The Committee offers the government the alternative of
- (a) setting the levels of the new exemptions at the equivalent of the present spouses' and small estate exemptions which will cause a loss of about 30% in revenue, or
 - (b) setting them at levels which are reasonable in themselves which will maintain the revenue, at the cost of increasing the number of taxable estates.

Chapter IV Farms

The Committee recommends that, in addition to its general recommendations relating to the payment of duty, the once-in-a-lifetime gift concept contained in the former federal Income Tax Act be adopted into the Ontario Gift Tax Act in modified form. The Committee also recommends that where the fair market value of farm land exceeds its agricultural value duty on the difference be deferred, subject to the registration of a lien against the property. (pages 33 - 37).

Chapter V Gift Tax

The Committee is skeptical about the need for a gift tax. The Committee recommends four amendments to the existing legislation if it is retained. (pages 38 - 41).

Chapter VI Persons and Property to be Taxed

The Committee recommends that a new statute should continue to tax property situate in Ontario on the death of a person wheresoever he is domiciled. In addition the Committee recommends that the present "transmissions" basis of taxation be replaced by an "accessions" basis. (pages 42 - 49).

Foreign tax credits should be granted in respect of all foreign death taxes levied on property situated according to Ontario law in jurisdiction levying the tax. Ontario should seek federal assistance to negotiate death tax conventions with the United States and other major jurisdictions. (pages 49 - 52).

Chapter VII Extended Definition of Taxable Estate

The Committee suggests adoption and definition of the term "property of the deceased" in lieu of "property passing on death" using the meaning set forth in the federal Estate Tax Act with the following minor modifications

- The Committee recommends a draw-back period for inter vivos gifts of three years unless The Gift Tax Act is repealed in which event it should be longer. (pages 56 - 57).
- The Committee recommends the taxation of jointly-held property in terms of beneficial interest rather than in terms of contribution. (pages 65 - 68).

- The Committee recommends that the fair market value of property of the deceased sold after his death pursuant to a buy-sell agreement entered into during his lifetime at arm's length and in good faith will be deemed to be the price payable under the agreement, provided the agreement is uncontested as between the two parties when exercised. (pages 64 - 66).

The Committee considers that the present exemption (and deduction from aggregate) under section 5(1)(h) of the Act, relating to non-commutable annuities is unjustifiable in principle and should not be continued in a new Act. (pages 68 - 69).

The Committee proposes a number of changes in determining the dutiability of insurance proceeds. (pages 70 - 73).

- The existing "premium payment" test be replaced by a test of ownership.
- Group life insurance proceeds should be dutiable except to the extent they are paid to the owner of the master group contract.
- Accidental death insurance or any other type of insurance payable by reason of the death of the deceased be dutiable whether under a group or individually owned insurance contract.

Insurance proceeds on a policy owned by a corporation controlled by the deceased should be dutiable to the extent they are payable to persons related to the deceased. Proceeds payable to the corporation would be dutiable only to the extent that they exceed a reasonable provision for the loss of a "key man".

Other technical changes and definitions are proposed.

Chapter VIII Valuations

The Committee recommends that value for duty purposes be defined simply as the "fair market value" of the property at the applicable date. (pages 77 - 83). Also that

- dispositions be valued as at the date of the disposition, (page 83) and

- life insurance policies be valued at their cash surrender value unless assigned within one year of death. In this case value will be presumed to be the policy proceeds. (pages 83 - 84).

The Committee recommends the use of new interest rates and mortality tables for valuation purposes. (pages 84 - 86).

Chapter IX Procedural Aspects

The Committee recommends a system of two returns and that the second should be drawn so that consents to transfer can be photographically reproduced. (pages 87 - 89).

Changes are proposed to probate and filing fees. (pages 89 - 91).

- Surrogate fees should be a fixed fee of \$25.00 in respect to each application for probate or administration, which in effect is a processing fee only.
- A filing fee should be imposed on each filing of an Affidavit of Value and Relationship under The Succession Duty Act of one half of one percent of the value of assets declared thereon, less a \$25.00 deduction where an application to the Surrogate Court has been made or will be made, upon proof of payment of Surrogate Court fees.
- No filing fee shall be levied where the total disclosed by the Affidavit of Value and Relationship does not exceed \$5,000.00.

The Committee recommends that duties in general be payable six months after death with two exceptions. (pages 91 - 93).

- All beneficiaries should have the option to pay duties in monthly, quarterly or annual instalments over any period up to ten years, provided that interest is paid and security lodged;
- income beneficiaries should have the option to pay duties over the terms of their benefit with interest on a fully amortized monthly, quarterly or annual basis with payments being calculated on the basis of the initially-assumed length of the term.

Rates of duty should be more readily determined: (pages 96 - 97).

- The progressivity of rates should be based upon either the size of the estate or the size of the inheritance but not both.

- Where a beneficiary is entitled to be exonerated from duty out of a tax free fund, his rates otherwise calculated shall be increased according to the formula $R = r + r^2 + r^3$ where R is the adjusted rate, and r is the rate initially determined.

Chapter X Administrative Considerations

The Committee makes a number of recommendations relating to procedural provisions in the statute. (pages 104 - 111).

Chapter XI The Structure and Language of the Statute

The language of the new statute should be simplified. (page 112).

Insofar as the new statute brings into tax inter vivos transactions exempt under present law, a date in the statute should prevent a retrospective effect being given to the new charging provisions. (pages 112 - 114).

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THE MAJOR ISSUES

Background of our report

The Committee does not view its role as requiring it to reach conclusions as to desirability or otherwise of retaining a succession duty. We view this as essentially a political question on which members of the Committee hold differing opinions. However we felt it would be useful to include as Appendix D some of the considerations which bear on this issue.

In his Budget Speech of March 4, 1969, the Treasurer of Ontario, The Honourable Charles MacNaughton stated the policy of the government with respect to the future succession duties as follows:

"As capital gains taxation becomes fully mature in the years ahead, undue accumulations of wealth will be moderated. In Ontario's view, therefore, the need for taxation of estates will diminish and such taxation should be gradually eliminated."

In the Budget of March 28, 1972, The Honourable W. Darcy McKeough announced the formation of this Committee in these terms:

"The Committee's terms of reference will include an examination of the relationships between succession duties and the family farm, family businesses and the question of Canadian vs. foreign control. The main objectives we seek in drawing up new legislation will be an equitable incidence, a minimum of adverse economic effects and greater simplicity. At the same time, the Government intends to continue its policy of gradually reducing the level of succession duties as the capital gains tax matures."

Earlier, in a special session of the Legislative Assembly on December 13, 1971, Mr. McKeough introduced a number of interim measures to protect provincial revenues from the results of the federal government's sudden withdrawal from the estate tax field. In so doing he stated that

"The Ontario Government accepts full responsibility for an appropriate level of taxation in this field. Our tax effort in this area would be judged in future years against the effectiveness of the taxation of capital gains. In other words, as the tax on capital gains gradually matures, our succession duties can be phased down. In the end there may no longer be any need for us to levy succession duties upon death. At such time, wealth accumulations will have been subject to income and capital gains taxation and therefore will have paid their fair share on a current basis."

There remains the question as to the time period over which the succession duty can be phased down. This is also a question which the Committee does not feel competent to deal with fully. We believe that the timing of such a move must depend in part upon revenue considerations about which we share no special insight. It also requires consideration of the impact of Ontario's withdrawal upon the provinces now imposing such a tax, just as Ontario must consider the impact of moves taken or proposed by other provinces to vacate this taxing field.

Accordingly the Committee prepared its report on the assumption that Ontario would continue to levy a succession duty at least for the time being. In so doing we would like to make clear that the members of the Committee are neither recommending the retention of such a tax nor its immediate repeal. However if the government retains the tax, even for a short period of time, we view a major revision of the statute as being essential. Our report details the changes which we believe are necessary.

Federal tax changes

The federal abolition of estate tax and the imposition of income tax on realizations of capital property at death leaves Ontario with no completely satisfactory option. The Committee recommends that the federal government be asked to amend the Income Tax Act so as to eliminate the deemed realization provisions at death. Pending this, the Committee recommends that Ontario exempt from duty capital gains and recaptured capital cost allowances subject to income tax at the time of death by granting a tax credit.

Probably the most significant reason for the appointment of this Committee was the decision taken by the federal government to impose a tax on capital gains, including gains accrued to the date of death, and to abandon the estate tax. The decision to abandon the estate tax was justified on the grounds that first, the combined impact of the two taxes at death could be severe; and second, any significant reduction of estate tax rates would reduce the federal government's already small share of estate tax revenue to an insignificant level. The considerations which led the federal government to this conclusion will not be discussed here other than to suggest that the announcement neatly shifted full responsibility for imposing death taxes to the provinces with the added implication that a combined death tax and capital gains tax produces an unacceptable double burden of tax at death. It is this latter issue that has been referred to the Committee for study.

Under the new Income Tax Act, net taxable capital gains realized after 1971 are to be included in income, subject to normal income tax rates. However to recognize the distinction between capital gains and ordinary income, it is only one half of the actual gain that is to be included. In effect, therefore, capital gains are subject to tax at one half normal tax rates, that is at rates ranging from approximately 10% to a maximum of 30% depending on income levels. Further, the portion of any gain which can be said to have accrued prior to 1972 will be excluded.

While normally gains are to be taxed only when realized, individuals are deemed to sell their capital property immediately before death and to realize proceeds equal to the current fair market value. If the deceased dies possessed of property which has grown substantially in value after 1971 and has not realized the gain for tax purposes, he may be

subject to tax on the gain at a maximum rate of approximately 30%. However, if the property is left to a surviving spouse tax may be deferred. In these circumstances, the survivor takes the cost base of the deceased when calculating the tax on any future gain.

Other forms of income are deemed to be realized immediately before death. The deceased is deemed to have disposed of his depreciable property for proceeds half-way between the "undepreciated capital cost" of the property and its fair market value at the time of his death, unless the property is left to the deceased's spouse. In this case, the spouse will assume the "capital cost" and the "undepreciated capital cost" of the property to the deceased.

Income rights existing at the time of death continue to be subject to tax in the year of death. To this has been added the requirement that a taxpayer in one of the professions, who had previously reported income on a cash basis, must include in income in the year of death any remaining untaxed portion of his interest in the 1971 accounts receivable of his professional practice.

One other factor must be considered. Taxable capital gains generally accrue only on certain classes of property. Principal residences, retirement plan benefits, insurance proceeds, savings and fixed interest bearing investments are unlikely to produce significant capital gains or losses. Most such gains or losses will accrue on investments in common shares, in real estate and in private companies or businesses. The resulting burden of double tax thus depends upon the "mix" of the particular estate.

An analysis of Ontario estates prepared for The Ontario Committee on Taxation provides some guideline as to the average dispersion of assets.

Relative Importance of Each Type of
Asset by Estate Size

<u>Type of asset</u>	<u>\$300,000 - 399,999</u>	<u>\$500,000 - 599,999</u>	<u>\$700,000 - 799,999</u>	<u>\$1,000,000 and over</u>
Property subject to tax on capital gains -				
Real estate, other than homes or farms	9.1%	1.6%	6.7%	0.7%
Common stocks with quoted values	27.2	32.2	20.3	42.6
Common stocks without quoted values	4.3	4.3	-	3.7
Interest in unincorporated businesses	<u>2.1</u>	<u>-</u>	<u>-</u>	<u>-</u>
Sub total	42.7	38.1	27.0	47.0
Property not generally subject to tax on capital gains (e.g. insurance proceeds, homes, retirement plans, bonds, etc.) -	<u>57.3</u>	<u>61.9</u>	<u>73.0</u>	<u>53.0</u>
Total	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>

These percentages suggest that on average, less than one half of the assets held by Ontario estates are capable of producing capital gains or losses.

These calculations do not reflect the position of the taxpayer whose estate does not conform to the average. It is entirely possible that the estates of active, risk-taking entrepreneurs who die before they have had an opportunity to diversify their portfolios will consist almost entirely of unrealized capital gains on non-liquid assets where a substantial portion of the gain may have accrued after December 31, 1971 and hence fall subject to capital gains tax. It is this possibility which causes us concern.

Since income taxes payable by the deceased are allowed as a deduction in computing the net taxable value of the estate for succession duty purposes the combined capital gains tax and succession duties that could be imposed under the present tax system upon property which has risen in value is illustrated in the following examples.

CASE I

Estate with a current value of \$300,000 (before deduction
for tax on capital gain) passing in equal
shares to two adult children

Proportion of estate represented by a gain or loss	90%	25%	25% loss
Tax (recovery) on capital gain - at 30%	\$ <u>81,000</u>	\$ <u>22,500</u>	\$ <u>(22,500)</u>
Net aggregate value	<u>219,000</u>	<u>267,500</u>	<u>322,500</u>
Succession duty rate	17.36%	18.32%	19.28%
Succession duty	\$ <u>38,018</u>	\$ <u>49,006</u>	\$ <u>62,178</u>
Combined tax as a percentage of current value	<u>39.69%</u>	<u>23.84%</u>	<u>13.22%</u>

CASE II

Estate with a current value of \$700,000 (before deduction
for tax on capital gain) passing in equal
shares to two adult children

Proportion of estate represented by a gain or loss	90%	25%	25% loss
Tax (recovery) on capital gain - at 30%	\$ <u>189,000</u>	\$ <u>52,500</u>	\$ <u>(52,500)</u>
Net aggregate value	<u>511,000</u>	<u>647,500</u>	<u>752,500</u>
Succession duty rate	21.80%	23.92%	26.04%
Succession duty	\$ <u>111,398</u>	\$ <u>154,284</u>	\$ <u>195,951</u>
Combined tax as a percentage of current value	<u>42.91%</u>	<u>29.54%</u>	<u>20.49%</u>

CASE III

Estate with a current value of \$2,000,000 (before deduction
for tax on capital gain) passing in equal
shares to two adult children

Proportion of estate represented by a gain or loss	90%	25%	25% loss
Tax (recovery) on capital gain - at 30%	\$ <u>540,000</u>	\$ <u>150,000</u>	\$ <u>(150,000)</u>
Net aggregate value	<u>1,460,000</u>	<u>1,850,000</u>	<u>2,150,000</u>
Succession duty rate	33.52%	36.94%	38.66%
Succession duty	\$ <u>489,392</u>	\$ <u>683,390</u>	\$ <u>831,190</u>
Combined tax as a percentage of current value	<u>51.46%</u>	<u>41.66%</u>	<u>34.05%</u>

The foregoing illustrations suggest the following propositions:

1. The combined impact of tax on the capital gain is more apparent in the case of smaller estates than larger estates. For example, in Case I, a \$300,000 estate taxed at 19% under The Succession Duty Act, could bear a combined tax of from 13% (where there is a capital loss) to 40% (where most of the estate consists of a gain).
On the other hand, in Case III, a \$2,000,000 estate taxed at 38% under The Succession Duty Act could bear a combined tax of from 34% to 51%, given the same assumptions.
2. The combined rate of tax at death tends to be less progressive as the proportion of the estate consisting of capital gains increases.

CASE IV

Estate with a current value of \$700,000 (before deduction of tax on capital gain) passing in equal shares to two adult children. Property in this case consists of rental real estate.

Assumptions:

	<u>Capital cost</u>	<u>V-Day Value</u>	<u>Undepreciated capital cost</u>	<u>Fair market value</u>
Land	\$ 80,000	\$105,000		\$140,000
Building	<u>360,000</u>	<u>420,000</u>	<u>120,000</u>	<u>560,000</u>
	<u>\$440,000</u>	<u>\$525,000</u>		<u>\$700,000</u>
Deemed disposition price -				
Land		\$140,000		
Building		340,000		
Income deemed realized				
Gain on land (1/2 of \$35,000)			\$ 17,500	
Recapture on building			<u>220,000</u>	
			<u>\$237,500</u>	
Income tax - at 1972 rates assuming other income equals personal exemptions plus allowed deductions				
			<u>\$134,100</u>	
Net aggregate value			<u>\$565,900</u>	
Succession duty rate			22.52%	
Succession duty			<u>\$127,441</u>	
Combined tax as a percentage of current value			<u>37.36%</u>	

However, in order to pay duty, the property must be sold.

If the property is sold by the estate for \$700,000, its value for duty purposes, a further tax on recaptured capital cost allowances and the capital gain is imposed.

Deemed Building Sale proceeds	\$560,000
Deemed cost	360,000
Deemed Undepreciated capital cost	340,000
Amount subject to tax	
Capital gain realized of which 1/2 of \$140,000 is taxable	\$ 70,000
Recapture	<u>20,000</u>
	<u>\$ 90,000</u>
Income tax - at 1972 rates assuming no other income to the estate	<u>\$ 45,600</u>
Total taxes payable at death and later on sale	<u>\$307,141</u>
Combined tax as a percentage of current value	<u>43.88%</u>

Case IV illustrates the effect of the partial realization provisions of the Income Tax Act upon the amount of duty payable. This differs from the full realization treatment given other capital property which permits the estate to deduct the tax on the gain deemed to be realized on death in computing the net dutiable value of the estate. When the gain is only partially realized, as in the case of depreciable property, part of the tax on the capital gain and on recapture is not allowed as a deduction to the estate for duty even though the full gain is realized immediately after death.

In this example, if the full fair market value had been deemed to have been realized at the date of death, succession duties would have been reduced by \$15,847. (This reduction might be partially offset because of higher income tax rates payable on the remaining portion of the recaptured capital cost allowance and capital gain which would be taxed in the year of death.)

It is clear that the effect of the provisions allowing a partial deferral of capital gains; and perhaps more significantly, the full deferral on transfers to a surviving spouse, serve to increase succession duties in spite of their intended beneficial impact on taxpayers.

The Committee has expressed its concern that the combined impact of the two taxes at death could be severe in some cases and may sometimes force the liquidation of the property concerned. However this problem is not easily resolved. There appear to be four alternatives open, none of which is wholly satisfactory.

- (1) The Province could progressively increase the level of exemptions for succession duty purposes. While this step may be desirable for other reasons, it is in our view only a crude solution to the double impact problem, in that it benefits all estates while the double impact problem seriously affects only a few. Indeed it fails to resolve the problem for the few most seriously affected.
- (2) The federal government has created this problem and the best solution for Ontario is to persuade the senior government to alter its Income Tax Act so as to eliminate the deemed realization provisions at death.

This would be entirely practical for the federal government. It could allow assets to pass to beneficiaries at their fair market value without charging the deceased with the gain as is done under both the U.S. and U.K. systems (and as was done for the purposes of valuing depreciable assets in the hands of beneficiaries under the Canadian income tax laws up to December 31, 1971). Alternatively it could allow assets to pass to beneficiaries at the deceased's

cost base which is proposed as the new system in the U.S. (and is the system in the case of transmissions to spouses under the present Canadian law).^{*} That there are arguments for and against each solution is obvious; but it must be emphasized that there is no difficulty in drafting the required amendment.

While this alternative may provide a satisfactory solution to the problem, it requires a change in the federal law which the federal government may be unwilling to make. In any event this solution would take time to negotiate.

- (3) The succession duty rates could be lowered to a level at which the combined impact of the two taxes levied at death would not impose an intolerable burden on most estates.

The defect in this solution is that it cannot deal satisfactorily with estates composed largely of capital gains or with capital cost allowances which are recaptured on death or on the executor's sale thereafter. Much less publicity has been given to the issue of capital cost allowances recaptured at death than to capital gains deemed to be realized at death, but in certain cases the resulting taxes would be far higher under the new income tax law.

^{*}The February 19, 1973 federal Budget resolutions suggested that this treatment be extended to include the transfer of family farms to the next generation.

- (4) Ontario could, in effect, exclude from its succession duty a portion of capital property, that is the portion represented by capital gains and recaptured capital cost allowances, which are subject to income tax at the time of death.

The form by which this could be accomplished would be a credit, like the present foreign tax credit, against the succession duty for the amount of income taxes payable on capital cost allowances and capital gains realized on the deemed disposition of capital property at death.

By this technique the taxpayer would only suffer one tax on such capital gains or recaptured depreciation, the one tax being the one which bears the higher rates in the particular context.

For other reasons which are discussed later in this report, the Committee has concluded that rates of duty should be reduced from their present maximum levels. We suggest that the maximum rate should be about 30%. Pending federal action or Ontario's departure from the field as described above, this Committee has no reasonable alternative but to recommend that Ontario introduce this income tax credit described more fully in Chapter IX.

Acceptance of this recommendation represents a surrender by the Province of its right to succession duty on property subject to income tax, a tax payable largely to the federal government. Three observations are in order.

First the actual cost to Ontario in the near future should be minimal. As we have pointed out above, the problem is not at this stage widespread or common; the difficulty will occur in significant degree only rarely in the near future but then it will be so acute that the results will be seen as unjust to the taxpayers.

Second, as the capital gains system matures with the realization of more and more taxable growth achieved after V-Day, Ontario will gain increasing amounts of revenue from its share of the income tax levy. As successive and former Provincial Treasurers have said, in these circumstances it is appropriate for Ontario to arrange a staged retirement from the succession duty field. We suggest that the retirement might appropriately match the increasing effect of the income tax levies on Ontario estates. Our fourth option does exactly this.

Third, Ontario might reasonably seek fiscal compensation from the federal authority for its abandonment of an historic, pre-twentieth century Ontario taxing field.

The Committee acknowledges both the technical and conceptual difficulties involved in any tax credit arrangement.

1. A credit for tax on gains accrued at the date of death is non-neutral. If the individual sells his appreciated capital investment prior to death, he will face tax on the realized gain but would not qualify for the credit even if death occurs on the following day, (but in this case the estate would pay less duty because of the reduction in the size of the estate). The individual might thus be persuaded to retain his appreciated property until he dies (the so-called "locking-in effect"). While neutrality is a desirable objective, there may be occasions when it should yield to some other principle; in this case, the principle of avoiding an unreasonably high tax burden at death.

2. Parliament has seen fit to create several routes whereby cash may be received but not treated as taxable income on condition that the recipient increases his ultimate tax liability on the sale of the asset or at death. Under our proposal such an individual could take full advantage of the technique, hold the property until death, and then obtain a succession duty credit for the tax bill. The Committee views this result as one which has been imposed on the province by changes to the income tax system.

3. The introduction of a tax credit requires drawing a distinction between amounts eligible for the credit and those which are not. Such a distinction is not easily made. In the end, the Committee concluded that a credit should be allowed for tax on gains in respect of capital property, including recaptured capital cost allowances, but not for tax on other items such as income rights, death benefits or previously untaxed interests in the accounts receivable of a taxpayer in one of the professions.

Notwithstanding all the difficulties with the tax credit arrangement, we are of the view that Ontario should adopt it. Ontario must solve the problem of the deeply felt burden of two, separate, unintegrated, different death taxes. If Ontario made no other change to its statute it would, in solving this problem, have done much to remove the primary ground of complaint with the present death duty system in the Province.

II

THE PRESENT STATUTE

The Committee urges the immediate repeal of the Succession Duty Act and the simultaneous enactment of a modern simplified death tax.

The present Ontario Act dates from 1892 and many of the original provisions have survived intact the almost annual revisions which have been superimposed in the interval. The effect might be considered quaint and thus similar to, say, The Line Fences Act or The Dower Act were it not for the fact that it is a revenue statute expected to collect some \$75 millions annually from only 2,000 estates, or \$37,500 per estate on average. We do not feel it necessary to summarize the present law in this report, but we might quote the following conclusion reached by The Ontario Committee on Taxation in 1967.

57. This brief summary should give the reader a notion of the bewildering complexity of the tax and as it is now applied in Ontario. The actual statute that dictates these intricacies is frequently so abstruse that it has gained almost universal notoriety among practitioners as being the worst piece of tax legislation on the books of the Province. One writer has called it unpardonable; certainly a thorough rewriting of the Act is long overdue. In succeeding sections of this chapter we will examine many of the provisions in detail and propose a new format for the tax that would considerably simplify the statute.*

The need is not simply to update the terminology or to simplify the statute. We see the present Act condemned for more serious offenses.

We cannot justify the substantial differences in tax that fall on similar estates simply because of minor differences in the provisions in the will. For example a man dies leaving an estate of \$300,000 - a comfortable but not an enormous estate, for the benefit of his widow, age 60 and their two adult children. Duties could range from a low of \$13,165 to a high of \$57,000 under the following alternatives:

* The Report of The Ontario Committee on Taxation, 1967 Vol. III pages 146-147

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|--|----------|----------|
| (1) The estate is left outright to the widow.
Later, the widow (having no other assets of
her own) passes this amount to two adult
children | - no tax | |
| | - tax | \$57,000 |
| (2) The husband leaves a life interest in the
estate to his widow with the remainder
passing to the two children on her death
(no further tax on widow's death) | - tax | \$21,394 |
| (3) The husband leaves \$100,000 outright to his
widow and a life interest on the remainder
which is left after her death to the two
children (no further tax on widow's death) | - tax | \$13,165 |

If the children were dependent, and even if the estate were left to the dependent children exclusively, with nothing to the widow, no tax whatever would be payable.

While these results might be considered to be bizarre, consider the tax which would fall in the event that the husband and wife are both killed leaving

- | | | |
|----------------------------|-------|----------|
| (1) Two adult children | - tax | \$57,000 |
| (2) Two dependent children | - tax | \$52,000 |

These duties have been calculated after giving recognition to the substantial increase in exemptions announced in 1972. We view it as unfortunate that, while exemptions for widows were increased to \$500,000, exemptions for surviving children remain very low even when the children were fully dependent at the time of their parents' death.

Equitable distribution of the tax burden also suffers because of the ease with which the tax can be reduced substantially - even avoided completely in some circumstances by perfectly legal estate planning measures.

For example, a widower wishes to secure the future for his totally dependent crippled adult daughter. If he leaves her a fund of \$150,000 by his will, the transaction will be taxed. If that is the entire estate, the tax would amount to about \$25,000. But if he left her an income in the form of an annuity, purchased in his lifetime, securing her \$10,000 a year for life, there would be no tax at all.

Again, if a widow leaves her estate of \$1,000,000 to her two adult children, tax would amount to \$300,000 and each child would receive \$350,000. But if the widow were to leave \$392,500 to each child free of tax, and the residue to charity, duty payable out of the residue would virtually exhaust it, leaving the charity with nothing, while each child would be \$42,500 better off.

Again, suppose a terminally ill man with a \$1,000,000 estate consisting of assets in Ontario intends to leave the whole to his wife. The duties would be \$175,000. But if he consults sophisticated advisors they will indicate that, in view of his probable early demise, he would be well advised to pledge his assets with a bank, borrow \$1,000,000 and buy Alberta real estate. If his assets at death consisted of \$1,000,000 of Ontario assets, less a \$1,000,000 liability to a bank, plus \$1,000,000 of Alberta real estate, no duties would be payable. The advisors would stress the early demise because, as they would point out, it is the general expectation that Ontario will shortly revise its Succession Duty law.

Again, at a moderate cost in fees, a man could transfer all his assets to an Alberta holding company, cause his heirs to incorporate their own Alberta company, and then by his will leave the shares of his company to their company. This device may avoid Ontario succession duties regardless of any other factor, including the size of his estate. If the Canadian income tax laws make the use of Alberta companies inadvisable, then the planner can choose among such readily available, if geographically invisible, jurisdictions as Liechtenstein (whose companies law is remarkable for its liberality), the Netherlands Antilles, or Monaco and many others.

No doubt many other devices are also in current use. However, we trust that the foregoing will illustrate the enormous differences in duty and hence the "benefits" available to estate planners through the use of loopholes in the present law. It seems hardly necessary to add that a complete redrafting of the Succession Duty Act is urgently needed.

III

RATES AND EXEMPTIONS

The Committee proposes a moderately progressive rate structure with rates ranging from a low of 10% to a high of 30%.

The case for lower rates

The Committee acknowledges that any determination of appropriate rates and exemptions must depend upon both the absolute revenue needs of the province and upon the desired tax mix (i.e. the degree to which the province is prepared to rely upon succession duty to meet its revenue needs). Generally the Committee's recommendations are presented on the assumption that any new succession duty statute should produce approximately the same total dollar revenue as the existing system. However we believe that succession duty rates should be substantially reduced.

In reaching this conclusion, our Committee considered a number of factors:

1. The existing high rates of succession duty act as one of the principal reasons why wealthy persons leave Ontario for tax havens or more lightly-taxed nations or provinces. Although it is impossible to measure this circumstance either in terms of numbers of persons, or revenue lost, it is possible that the loss to the Province in terms of income tax, sales taxes, loss of job creating capital, etc., may well exceed the revenue that succession duties contribute. The present high rates of succession duties may well be counter-productive.

2. Similarly, it has become obvious to our Committee that death taxes are to some extent a "discretionary tax". A taxpayer may, by perfectly legal means, lessen the amount of duties if he is prepared to retain sophisticated professional advice and arrange his estate in a suitable manner. The incidence of death taxes may, therefore, be falling more heavily on those whose estates are not sufficiently large to afford the sophisticated estate planning that is available in Toronto and other large metropolitan areas.
3. Legal tax avoidance is unconstructive activity but if taxes are high enough it becomes worthwhile for a businessman to spend more time and money in avoiding taxes than in enhancing the production and efficiency of his enterprise. Death duties, therefore, unfortunately can be considered a deterrent to the most productive employment of the talents of our more enterprising citizens.
4. Our chief concern, however, in suggesting lower rates lies in the effect of succession duties on our ability to control our own economy in the face of the increasing domination of our business life by large corporations particularly those controlled by non-residents.

The bulk of Ontario succession duties are paid by Ontario resident individuals and not by non-residents or by corporations. Capital gains taxes exigible on death are likewise only paid by individuals. Foreigners are generally exempted from Canadian capital gains tax and corporations never die. Any wealth tax such as succession duties or the capital gains tax at death, designed specifically to

tax Ontario residents and to exempt non-residents and corporations, must in the long run be a contributing factor to the shifts in control of our economy from Canadians to non-residents and from individuals to corporations.

5. The combined impact of succession duty and capital gains tax at death falls severely on the proprietors of family owned businesses. A successful entrepreneur who has built up a business is almost inevitably the person who will have the greatest potential capital gains tax. Often in cases such as these, most of the earnings have been retained in the business so that the entrepreneur has few, if any, liquid assets to pay the two death taxes. When an entrepreneur reaches his fifties, he will arrive at an age when he should seriously consider estate planning. Often this is the time, if his business is successful, that he may require additional capital to expand his plant, etc. The entrepreneur is faced with the dilemma of needing more money to finance his business and the need to look ahead to the day when his estate must raise death taxes. He may opt against further expansion, and he is also put in a position where an offer from an outsider to buy his business becomes attractive.

The Committee recommends that any new scale of rates should be designed to produce lower marginal and effective rates with a top marginal rate of about 30%.

The Committee proposes, in addition, a new pattern of exemptions. If revenues are to be maintained, the new exemptions can be set at levels which will provide deductions for a spouse or other dependant equal to the money for ordinary self-supporting decency without tax. As a principle, we are inclined

to doubt the wisdom of the present exemptions which may provide a spouse with tax-free wealth far beyond ordinary means, but which produce too little exemption in the case of children, especially orphans, and other dependants.

If a new pattern of exemptions is adopted at the levels proposed later in this Chapter, it becomes possible to achieve the present yield with an average effective rate of 20% of the taxable portion of taxable estates with a scale of marginal rates running from 10% to 30%. (Under the present Act the comparable effective rate is 25% with a scale of marginal rates running from 10% to 50%.)

The Background of our Recommendations

Successive budgets have increased the widow's exemption and much more significantly have increased the category of totally exempt estates. The pattern is as follows:

<u>Date</u>	<u>Widow's Exemption</u>	<u>What is left of widow's portion of 1972 tax base (millions)</u>	<u>General Exemption</u>	<u>What is left of 1972 tax base (millions)</u>
1965	\$ 60,000	\$122	\$ 50,000	\$753
1966	75,000	99	50,000	753
1970	125,000	51	50,000	753
1971	250,000	15	100,000	491
1972	500,000	0.11	100,000*	439

As a result one can state the problem this way. If there were no exemptions at all, an effective flat rate of 6% would raise \$75 million

* The exemptions prior to 1972 in this category applied to the total gifts going to preferred beneficiaries only. The change in 1972 exempted all estates regardless of to whom they were left which added up to less than \$100,000.

which is the currently expected total for the fiscal year 1972-3. This total includes much revenue derived from estates taxed under the lower exemptions in force before 1972. But given all the present exemptions, the effective average rate would have to be about 30% to achieve the same result. The Committee does not believe in flat rates. It believes in progressive rates which charge people who have more with more of the burden.

If the province accepts the Committee's recommendation to lower succession duty rates, the expected revenue cannot be achieved unless very significant changes are made in the present pattern of exemptions. This would have the result of taxing more estates, mostly small estates not left to dependants. The Committee has worked out several alternate models, all involving a top marginal rate of 30%, which appear to produce yields roughly equal to the present, but which involve taxing approximately 9,500 estates out of a total of 57,000 deaths per annum. These models are set out in Appendix B. (At present, only 2,000 estates are taxed. However, in our models, tax is imposed on only 1.6 persons per estate for a total of 15,500 persons as opposed to 3.0 persons per estate at present for a total of 6,000 persons.)

If, on the other hand, the province feels that it must maintain the present level of exemptions and is prepared to lower rates along the lines of one or other of the Committee's models, revenue will be reduced to between \$47.5 million and 58.5 million. At these levels of revenue, the cost of collection would increase from approximately 1.8% of gross revenue to approximately 3%.

Further reductions in revenue would sooner or later raise considerations of efficiency. Of all Ontario taxes, only the security transfer tax and the logging tax cost more than 3% to collect. In other words, at some point in the process of lowering the yield, the government would have to decide

whether the time and talents of the succession duty administration could not be better employed in another branch of the revenue and whether the political cost of the tax is justified by the yield.

Exemptions of Revenue Significance

The Committee proposes a new pattern of exemptions, and also proposes levels which would completely eliminate succession duties in respect of spouses and children and other dependants for the amount needed to maintain them in reasonable comfort, but charge them with tax on amounts in excess of this level.

Widows

The widows' exemption should be expressed, not as a capital sum but in terms of an exempt amount of annual income. The Committee suggests setting the level at \$15,000 per annum, which is far above the average for Ontario widows but recognizes that a higher figure may be more expedient.

In the case of a widow, the Committee suggests an exemption of the actuarial equivalent, calculated at a 5% rate, of an income of \$15,000 per annum for her lifetime, instead of the present \$500,000 exemption. This would provide enough income after taxes (of, say, \$3,000) for reasonable comfort. The Committee does not suggest that the balance in excess of this figure should be confiscated, but only that it should be subject to duty at reasonable rates. This would provide a larger exemption for the young widow than for the older one, which seems more reasonable than a flat amount. For example,

<u>Age of Widow</u>	<u>Exemption</u>
50	213,600
60	175,650
70	128,550

Each of these figures is far in excess of the average Ontario estate. (In fact, at current interest rates, the amounts above mentioned

would purchase an annuity of considerably more than \$15,000 per annum.) The Committee considers it is reasonable that persons who have more than average should help pay for the cost of government in Ontario, in proportion to their means.

If these exemptions seem unduly low, we suggest that the proper method of increasing them is to increase the annual amount above the \$15,000 level. It should be noted that the use of more modern actuarial tables (see recommendations in Chapter VIII) increases the widow's portion of an estate left to her for life and reduces the portion left to the remaindermen. Because of the widow's exemption, this shift has significant negative consequences to the Revenue which could be overcome only by

- increasing overall rates, or
- reducing exemptions.

Small Estate Exemption

The Committee suggests deleting the present small estate exemption and replacing it by a new exemption permitting each beneficiary the first \$10,000 of benefits tax free.

While the effect of the present exemption for spouses on the revenue yield from succession duties appears obvious, the effect of the current exemption on all estates under \$100,000 is less apparent. However, examination of statistical material shows that the province foregoes enormous revenues as a result of this exemption. The Committee feels that generous exemptions for dependent relatives are necessary and that some exemption for adult children and other non-dependent beneficiaries is also desirable in order to avoid taxing small inheritances. However, it is difficult to justify the enormous loss of revenue to the province as a result of its exempting all estates of less than \$100,000.

This exemption should be eliminated in any event, and be replaced by an exemption for each beneficiary. If this exemption is set at \$10,000 the consequent increase in the tax base enables the province to set rates at the lower levels which are more appropriate without losing revenue. If this exemption is not eliminated, a reduction in rates does mean a reduction in revenue.

The Committee recommends that a \$10,000 exemption be provided for any beneficiary regardless of relationship. Not only does this eliminate small estates, but also eliminates from tax the small beneficiaries of large estates.

Exemptions of little revenue significance which
the Committee views as being as socially
necessary or desirable

Dependent Children

The Committee proposes a higher exemption for dependent children.

At present, for duty purposes, children cease to be regarded as dependent and qualified for exemption at age 18. The present exemption levels are \$15,000 when there is also a surviving parent and \$25,000 when there is not. This method of determining dependancy and the application of a flat exemption requires changes. The Committee proposes that the exemption for each child be \$2,000 for each year that the age of the child at the date of the parent's death is less than twenty-six. Statistics Canada has informed the Committee that, during the next decade, children surviving a father will average age 36 on his death, and age 52 on their mother's death. About 30% of the children would be under age 26 on the father's death, but fewer than 3% on the mother's death. Hence his increase in exemptions will not be costly, or even measurable on the current computer model.

Where beneficiaries of an estate include the deceased's spouse and dependent children, the surviving spouse should be able to use the unused portion of the children's exemptions in addition to his or her own exemption.

Orphans

The Committee proposes a higher exemption for orphans.

The Committee has proposed that the widow's exemption be expressed as the present value of an annual sum (\$15,000) for her life. In dealing with orphans, the Committee suggests that they be allowed, in effect, to "hire themselves a mother" by granting them an exemption to be divided equally among all the orphaned children regardless of their age, of the present value of \$15,000 for the number of years until the youngest child reaches age 18. Statistics Canada indicates that there will be only about 50 to 100 orphans under age 18 per year in Ontario during the next decade. This exemption should be in addition to the dependent children's exemption described above.

Widowers

While the Committee does not believe that a widower's deduction is of pressing importance, except in cases of dependancy, it may be necessary to accord the same exemption to widowers as accorded widows.

The Committee does not regard a deduction for a widower as of pressing importance unless

1. he was a dependant, in fact, of his deceased wife, or
2. he has been left with minor children.

On the other hand, the principle of sexual equality may make assimilation of the case of the widower to the case of the widow politically unavoidable. In any event, Statistics Canada says widowers are rare. Only 20% of male deaths will be widowers. (If assimilation is not politically required, the Committee would suggest assimilation in case 1 only. In case

2, the Committee would suggest an exemption of the present value at 5% on the date of death, of \$15,000 per annum until the youngest child attains age 18.)

Adult Dependants

The Committee suggests a new exemption for adult dependants regardless of legal relationship.

Anyone can, in fact, be a dependant. The Committee suggests that if the burden of proof is placed on the claimant, the revenue will not risk much by offering up to 1/2 a widow's exemption to any adult person regardless of circumstances or relationship who can show that, in fact, he or she was dependent on the deceased.

Charity

The Committee suggests a broader definition of charity to include all charities recognized for income tax purposes.

The Committee proposes that a charitable deduction should be available, whether or not the charity carries on its work in Canada. This will permit deductions for gifts to organizations such as the Canadian Save the Children Fund and UNICEF. It will remove an annoying reduction in gifts to Canadian churches which carry on missions abroad. This will not be costly since only about 1% of the value of Ontario estates is left to charity.

A charitable organization registered for federal income tax purposes should qualify automatically for this exemption in order to avoid unnecessary duplication of administration. However, there are a few organizations which ought to qualify for exemption even though they are not registered for federal income tax purposes. These organizations should be

granted exemption by order-in-council upon application made within two years of death.

Gifts to the Crown

The Committee suggests a broader definition of a tax exemption, for lifetime or testamentary gifts to the Crown, in order to provide an exemption even where a donor or testator reserves certain life interest in the property.

There are a number of Ontario residents who own objects of priceless value to Canada for their beauty. In addition to the case of art, or things of aesthetic value, there is also the case of things of historic value. There are residents of Ontario who hold objects or documents beyond value for their role in informing or symbolizing the history of this and other countries.

Assets of this kind create the need for special consideration. Unquestionably, while not capable of providing income to their owner, they have a high tangible worth measured in money and give their owners intangible satisfaction. Hence, he has a set of dutiable assets and will have to pay duty on them unless any special consideration should apply.

This ownership symbolizes the fact that man does not live by bread alone, that things of beauty, symbols or artifacts of our history are capable of uplifting and inspiring generations of Canadians.

Canada and its provinces own museums and archives as repositories for the study and display of such treasures. Yet governments rarely can find enough money to effect purchase of them when they reach a competitive auction. All too often there is a wealthy foreign collector or gallery which is willing to pay the best price. In the long run, this will continue. Individually-

owned assets of this kind are sooner or later held by someone who is forced to realize on them. Death and taxes represent two possible occasions, and when they combine, the most likely occasion for the presentation of such assets into the market.

It is in the interest of Canada and of each of its provinces to prevent the public marketing of such treasures, and instead to obtain permanent ownership thereof for public galleries. In an arbitrary state this could be accomplished by simple fiat with the consequent confiscation of the owner's monetary interest. In a free society such confiscation, being basically a form of theft, is inappropriate.

More appropriate is the technique of persuasion through a combination of tax exemption and public honourable recognition.

In the Income Tax Act there is a limited but effective recognition of this technique in the provisions for a deduction from income without limit for the value of gifts to the Crown, and the proposed capital gains roll-over for tangible assets of value given to a public museum or municipality.

The Committee proposes that Ontario should go a good way to persuade effectively.

If the matter is left as at present that a deceased can give or leave his valuables to the Crown, or a Crown owned repository (the National Gallery, the National Archives, the Art Gallery of Ontario, the Ontario Heritage Foundation) and escape succession duty, Ontario can expect such legacies to continue, but to be rare.

The Committee suggests that one reason why such legacies are rare is the desire of their accumulator to see them (or envisage them post

mortem) in the homes of his children who were with him when he acquired them. The greater the accumulation, the more likely it is to be the work of a lifetime involving very deeply the life of the family of the accumulator.

It would therefore assist the public galleries in being the recipient of this form of charity if the private owner could still obtain exemption if the public ownership were deferred for a number of years to permit others, living at the deceased's death, to enjoy the objects.

Therefore, the Committee proposes an exemption in the following terms:

1. The deduction would be from aggregate if this is relevant.
2. The gift could be made during the donor's lifetime or by will.
3. The gallery concerned would have to be an institution of the Government of Canada or of a province.
4. The gift would have to be upon specific trust, or by specific agreement with the gallery concerned.
5. The asset would have to be accepted by the gallery concerned.
6. The owner (testator) would be entitled to make his gift subject to retention by himself for life, and up to two following life interests, provided that they are persons alive at the time of the gift.
7. The subject-matter of the gift would have to be housed and protected in a context which the gallery approves during the period before the gallery takes possession.
8. The subject-matter of the gift would have to be available to the public during the interim period in either of two forms:

- (a) if the temporary possessor agrees and the gallery concurs, by opening his home to the public at stipulated hours and always agreed to by him and subject to conditions of entry established by the gallery. (Such a regime would particularly suit the original accumulator of a grand collection and we recommend that, in appropriate cases, it be accompanied by a public contribution toward the maintenance of the objects and the building in which they are to be found.)
- (b) otherwise by removal of the objects to permit their inclusion in exhibitions in Canada and abroad at the discretion of the gallery for up to three months in each year.

The Committee suggests a broad definition of the assets which could be involved, including tangible chattels of all kinds, as well as real property (to which condition 8(b) above would be inapplicable).

It is reasonable to hope that, if this suggestion is adopted across the country, priceless national assets would gradually come into national or provincial ownership, to the enrichment of the quality of national life.

Insurance and Pension Benefits Payable to Non-Residents

Certain insurance and pension benefits payable to non-residents should be exempt.

Insurance and pension benefits payable to persons neither domiciled nor resident in Ontario should be exempt where the deceased was not domiciled in this province.

It is in Ontario's interest not to grant any more general exemption at this time, but whenever non-Ontario transfer agencies begin to operate to diminish Ontario's revenue from foreign estates owning Toronto-listed stock, consideration should be given to a reciprocal exemption such as that contained in Saskatchewan Act in respect of property left to the resident of a co-operating province.

Quick Succession

A quick succession relief should be granted.

The term "quick succession" is applied to the situation where property is taxed twice within a brief period of time because the beneficiary dies shortly after his benefactor.

The present Succession Duty Act makes no provision for a quick succession allowance. Section 37 of the Federal Estate Tax Act as it stood at December 31, 1971, provided where taxes become payable upon or in respect of particular property or the succession to particular property passing on the death of a person and where the death of the successor to that property occurred during the first year after the first death, the value of the property was to be reduced 50%. The allowance decreased by 10% per year if the second death occurred during the second, third, fourth or fifth years.

The Succession Duty Acts recently enacted by several provinces provide for a quick succession duty allowance of 50% of the value of the particular property where the death of the successor occurred within one year after the first death, but no allowance is given at all if the second death occurs after one year of the death of the first decedent.

The Committee's review of this matter has indicated many technical difficulties can be encountered since it is necessary to trace the property from one estate to another. However, since the administration of an estate generally continues for at least a twelve month period following the death of the deceased, the original property or that which can be identified as having been exchanged or substituted for that property during this period of time is readily traceable. Having regard to all circumstances, we consider the provision in the uniform Acts has dealt with the matter fairly. The Committee therefore recommends that relief be given only if the second death occurs within twelve months, and that it be limited to 50% of the value of the property.

IV

FARMS

The Committee recommends that, in addition to its general recommendations relating to the payment of duty, the once-in-a-lifetime gift concept contained in the former federal Income Tax Act be adopted into the Ontario Gift Tax Act in modified form. The Committee also recommends that where the fair market value of farm land exceeds its agricultural value duty on the difference be deferred, subject to the registration of a lien against the property.

The Committee was directed, in its terms of reference, to "enquire into and report to the Minister of Revenue upon the implication of the impact of succession duties on the family farm..."

There are a number of specific problems affecting Ontario farms in connection with succession duties and the Committee spent considerable time in seeking to understand the position of the farmer. It was ably assisted to this end by two of its members, Lyall MacLachlan, a farm management advisor, of the Ministry of Food and Agriculture, and Elmer Bell, Q.C., an experienced lawyer whose practice was centred in a rich agricultural area in western Ontario.

The Committee noted that farming generally yields a low rate of return on investment. Further, new technology in agriculture requires increased investment to protect even the present low rate of return. Since 1967 capital requirements for various types of farm enterprises have increased from one-third to one-half. We were advised that it would be impossible to find a viable farm enterprise returning a living wage to the farmer with a capital investment of less than \$100,000. In consequence liquidity becomes a major concern. The modern farmer is obliged to reinvest a high proportion of his profits if he is to keep his farm economically viable. Further, even

given the increasing amounts of machinery which he requires, it remains true that a very high percentage of his investment is in land which frequently appreciates in value by reason of factors which are unrelated to his yield from farming.

Many Ontario farms operate within the urban shadow, which extends over a very high proportion of the best Ontario farmland. This situation ought to represent a major concern of government. It is imperative that death tax laws do not operate to enhance the trend to turn rich farmland into weedy lots awaiting development. If the farmer can retain his farm within the urban shadow, it may be kept in production for another generation and, depending on developing government policies, possibly in perpetuity. It should also be noted that an identical problem occurs in the areas suitable for recreational use as, for example, the areas within some miles of the central Ontario ski areas.

We recommend that the tax laws should be such as not to force the sale of lands for non-agricultural use upon the death of their owners. We therefore submit that special provisions are needed to keep the land in production.

Certain of our recommendations of general effect will assist in meeting this objective. We have recommended, in Chapter IX ("Procedural Aspects") that any successor may defer duties over a period of up to ten years upon giving security to the Minister of Revenue and paying the proper interest. This recommendation will be of significance if adopted in any case of a liquidity problem and hence will be of particular relevance to farmers.

We have also recommended in Chapter V ("Gift Tax") that the annual gift tax exemption be expressed as simply \$10,000 per annum regardless of the number of persons to whom gifts are made. We have further recommended that any unused portion of the \$10,000 exemption be carried forward for up to three years and be added to the appropriate exemption in a later year.

Farmers made use of the exemption in the Income Tax Act as it stood to the end of 1971 which permitted a once-in-a-lifetime gift by a farmer who gave property to a child to be used in farming operations. The old exemption permitted a larger exempt value for such gift than the ordinary annual gift tax exemption then in force. We suggest that Ontario adopt the once-in-a-lifetime gift principle using a level of exemption which is realistic for Ontario farms in the 1970's. We suggest \$50,000. We suggest that the technical language should follow the old provisions of the Income Tax Act in the form adopted in the new Gift Tax Act of Saskatchewan (section 11)(2)). We would modify the Saskatchewan language in that we do not see why the gift might not be made to more than one person provided that all the donees are farmers. Nor do we see the logic of requiring that the gift be made only to a child in order to qualify for the exemption.

The urban shadow problem may be more broadly defined as the problem of any farm which on death has a fair market value higher than its value for agricultural purposes. In such cases we have recommended the adoption into legislation of a scheme based on the ad hoc arrangements worked out in a few cases in the Revenue Ministry under the authority of orders-in-council and passed pursuant to the Department of Revenue Act.

We propose that succession duties based on agricultural value be payable in the ordinary way on the death of the farmer. We propose that the

succession duties on the difference between agricultural value and fair market value should be capable of deferment at the election of the personal representatives of the deceased. If a deferment is elected, the Minister of Revenue will register a lien against the property for the amount of deferred duty with simple interest at the same rate as in any other case of deferred duties.

Whenever the property is sold or whenever the property ceases to be operated solely as a farm the lien would become payable in the full amount of principal and accrued interest, the payment to be made within a six-month period after it has become due. If not then paid the lien would be enforceable by foreclosure proceedings.

Should a farm already carrying a government lien for deferred succession duties be given on death or earlier to one or more persons who intend to carry on the farm, then, in the case of death at the election of the new owners, the original lien plus accumulated interest, would be replaced by a new lien for duties on the difference between the agricultural value at the second death and the fair market value at that time. The succession duties on the agricultural value at the second death would be payable in the ordinary way. In the case of a gift made in the lifetime of the farmer subject to the lien, the new owner could carry the lien if he agreed to assume it. This scheme would mean that succession duties would only be payable on the agricultural value for those farms operating within the urban or recreational shadow so long as the land is used for farming.

In order to limit the use of farms as tax shelters we would further require that the agricultural value of the property would be deemed to be an amount no less than the actual cost of the property paid by the deceased.

A provision of this kind will in no doubt be capable of use by the wealthy in connection with their "hobby" farms. We have faced this possibility and find it unobjectionable in that our intention is that nothing in the succession duty legislation should force a sale which may turn real farmland, regardless of who is the owner, into a speculator's vacant lot. We do not see any reason to enquire nor do we encourage the government to embark on enquiry as to the character, morals or wealth of the farmer who keeps the land in agricultural production.

Many modern farms are incorporated. The legislation should therefore cover the case of equity shares in a private company owning farmland. In such case the shares should be valued upon the alternate basis that the company's assets include farmland valued as agricultural land as compared with farmland valued at its fair market value. If the duties are lower assuming an agricultural value, the lien system could operate provided, however, that the lien is charged both on the land and against the shares.

Partial discharges of liens should be in the discretion of the Minister just as partial discharges of a mortgage are in the discretion of the mortgagee (where they have not been provided for in the instrument).

GIFT TAX

The Committee is skeptical about the need for a gift tax. The Committee recommends four amendments to the existing legislation if it is retained.

Your Committee considered whether there is any justification for the gift tax now in force. It should be noted:

- (1) It produces very little revenue. The revenue figures under the gift tax provisions of the Income Tax Act as in force to the end of 1971 indicate that the total revenue from this source never exceeded \$5 million, of which about one-half was derived from the pockets of Ontario donors.

The revenue is insignificant compared with the sums spent by taxpayers in the form of legal and accounting fees in complying with the Act.

- (2) The gift tax was introduced in 1935 to protect the income tax revenue from income-splitting transfers. In retrospect the attribution rules* in the income tax law seem to have accomplished this objective more effectively. Thus in reforming the Income Tax Act the federal government felt no need to preserve the gift tax. Gift taxes are now assumed to be necessary to protect the death tax revenue. It is hard to feel confident about the current theoretical justification for the tax when that justification was never proposed when the tax first was imposed.

* See Sections 74 and 75 of the Income Tax Act (Canada) attributing to certain donors the income derived from their gifts for the purpose of calculating their income tax.

(3) Prior to 1935 there was not only a provincial death tax but also a separate provincial income tax system involving separate returns. Had Ontario then thought that a gift tax was necessary to protect the then important death tax revenues, it would have had an easy means of collecting it. Ontario and the other provinces which had been in the death tax field for many decades never considered the protection of a gift tax necessary until late in 1971 when, alarmed by an announced federal intention to abandon the field, they rushed in to fill the imagined breach.

(4) The United Kingdom has never enacted a gift tax despite virtually confiscatory death taxes and despite the alternation in power during this century of parties friendly to wealth, and parties hostile to it. It has sometimes been proposed but skepticism as to its benefits coupled with a realization of its cost in nuisance and administration has so far deterred legislation. As a corollary, the U.K. legislation draws back into a deceased's estate for tax purposes gifts made within a seven year period prior to death.

The Committee did not try very hard to reach a consensus on retention of gift taxes. It considered the issue somewhat academic for it, in that Ontario is co-operating with most of the other provinces and has entered into a collection agreement with the federal government in connection with the tax. Whatever the Committee should recommend would have to be weighed against considerations of intergovernmental co-operation.

It is fair to state that we were not enthusiastic about the tax and that we felt that a good case could be made for the proposition that human greed, acquisitiveness, and reluctance to accept ageing or to contemplate the inevitability of death would deter most large gifts whether or not there were a gift tax. If this proposition be true, it follows that the principal actual effect of the gift tax law is to interfere with and complicate small gifting programmes which no Canadian legislature has intended or now intends to tax. In the result then, acceptance of the proposition logically would lead to the conclusion that the gift tax should be repealed and the add-back period extended.

If the tax is retained, we are unanimous in the view that four amendments are required.

- (1) Under the present Gift Tax Act outright gifts to spouses are exempted but gifts in trust for the benefit of a spouse are fully taxable. If gifts in trust were invariably utilized exclusively as tax avoidance devices, there might be some justification for this differential treatment. However, there are frequently valid non-tax reasons for making lifetime gifts in trust for the benefit of the donor's spouse, such as the protection of the capital from improvidence, the provision of skilled investment management and the protection of the donor's children in respect of the capital remaining at the spouse's death. Accordingly, we believe that the actuarial value of the spouse's interest in such a trust should be exempt from gift tax, while the actuarial values of the interests of any other beneficiaries in the trust should be treated as taxable

gifts in the year that the trust is established, subject to the \$10,000 annual exemption or any other applicable exemption. If, for example, a husband settles \$100,000 in trust giving his wife a life interest in the income, with the capital going to their children after her death, and if at her present age 58, her life interest in this trust is worth \$60,000, only \$40,000, the value of the children's remainder interest should be treated as a taxable gift.

- (2) The Committee favours the deletion of the present \$2,000 limit on gifts but the retention of the \$10,000 limit for the aggregate of gifts in the year. We recommend that unused parts of the \$10,000 be carried forward for 3 years.
- (3) Any number of gifts made by a donor upon the occasion of holidays, birthdays or anniversaries and aggregating not more than \$1,000 in the year would be exempt, would not be added back for death tax and would not be included in the \$10,000 limit.
- (4) We have recommended in Chapter IV ("Farms") following the lead of The Saskatchewan Gift Tax Act that once-in-a-lifetime gifts by a farmer giving property to be used in farming operations should carry a \$50,000 exemption.

We do not wish to inhibit the kind of reasonable gifts among family and friends which are likely to occur, and we are sure that these recommendations will not prejudice the tax base for death tax which will, in any event, be protected by the recommended three year recall of gifts on death.

These recommendations achieve for everyone the results which can already be achieved by many through the use of various technical devices.

VI

PERSONS AND PROPERTY TO BE TAXED

The Committee recommends that Ontario continue to tax property situate in Ontario on the death of a person wherever he is domiciled. In addition the Committee recommends that the present "transmissions" basis of taxation be replaced by an "accessions" basis.

Property owned by a deceased and passing on his death is subject to duty under two separate and non-overlapping subsections of Section 6 of the Ontario Succession Duty Act. First, duty is levied under Section 6(a) on all property situated in the province. Second, duty is levied under Section 6(b) upon a beneficiary who is resident or domiciled in the province and who inherits personal property situated outside the province which was owned by a deceased who died domiciled in the province; this latter tax is referred to as a tax on "transmissions".

In practice, Section 6(a) presents few problems in respect of tangible property, personal or real, movable or immovable; if the property is, as a matter of fact, within the province at the date of death, it is subject to tax. However, since the situs of intangible property such as shares of a corporation, bonds, promissory notes, book debts, patents, etc., is purely notional, determining the situs of such assets for succession duty purposes can be very difficult. In The King v National Trust Company, (1933) S.C.R. 670, the Supreme Court of Canada established three principles which have been applied in all subsequent litigation concerning the situs of intangible property.

- (1) For the purpose of determining situs as among the different provinces of Canada, property can have only one local situation;
- (2) The British North America Act requires that the situs of intangible property must be determined by reference to the principles of, or deducible from, those of the common law; and

- (3) A provincial legislature is not competent to prescribe the conditions fixing the situs of intangible property.

The decision in the National Trust case forced the provincial governments to rely upon the common law situs rules in administering their succession duty laws. Unfortunately, these rules suffer from two basic defects, first, they are rather abstruse, difficult to apply and productive of litigation and, second, they may encourage certain types of tax-oriented estate planning, which seek to alter the situs of property by the interposition of one or more holding companies. Even if the use of holding companies does not result in an actual reduction of total duties, it may permit an individual unilaterally to determine the situs of his property for succession duty purposes and thereby to determine to which jurisdiction his heirs will pay duty.

Accordingly, while the constitutionality of imposing duties under Section 6(a) on the basis of the situs of property in the province is entirely clear, there are dangers in excessive reliance on this basis of taxation. However, subject to our comments below, we see no satisfactory alternative to continued reliance upon this basis of taxation in respect of non-Ontario estates, where the beneficiaries are not residents of Ontario.

The Province of British Columbia has sought to counter the use of holding companies as a device for altering the situs of property by enacting Section 2(2)(k) of its Succession Duty Act. This provision subjects to succession duty a corporation which owns property in British Columbia, to the extent that its controlling shares or other securities pass on death, even if the corporation, the deceased owner of these shares or other securities

and the beneficiaries are neither resident nor domiciled in the province. We have doubts about the constitutionality of Section 2(2)(k) in its present form and, more important, we think that it is both wrong in principle and largely ineffective in operation. It is wrong in principle because it can create a situation in which double taxation is almost certain to occur.

For example, if an Ontario domiciliary leaves his controlling shares of an Ontario corporation to beneficiaries who are resident in Ontario, and if 40% of the assets of the Ontario corporation consist of property situated in British Columbia, British Columbia will, we understand, seek to collect succession duty from the corporation on 40% of the value of the deceased's shares. In these circumstances, since the deceased, his assets and his beneficiaries are all in Ontario, it would be entirely unreasonable, in our opinion, for Ontario to grant a "foreign tax credit" under Section 9 of the Ontario Act in respect of the British Columbia duty and unless Ontario grants such a credit, double taxation will result. Legislation such as Section 2(2)(k) is also ineffective, since it merely encourages those who wish to avoid its application to use two or more holding companies in series, thereby creating a situation in which the provision does not apply.

In our view, it is inadvisable for Ontario to adopt legislation similar to Section 2(2)(k) of the British Columbia statute in order to deal with estate planning techniques which alter the situs of property. This does not mean that we should be prepared to accept the use of such techniques. There are more satisfactory methods of coping with this problem. First, as noted below, we have recommended replacing the "transmissions basis" of taxation under Section 6(b) with an "accessions basis". This will subject

to duty any beneficiary who resides in Ontario and who inherits property situated outside Ontario, whether the deceased died domiciled in Ontario or elsewhere. Second, we have recommended that rates be reduced. Complex planning techniques designed to alter the situs of property all share one feature - they are costly to implement. This cost must be weighed by the planner against the possible future benefit, and the risk of changes in legislation, interpretation or political climate which would make the plan ineffective or worse. The more rates are lowered, the less likely it is that planners will wish to incur the expense and trouble involved in the use of tax havens for the siting of property.

There are two serious defects in the present Section 6(b):

First, Section 6(b) does not tax real property situated outside Ontario, even when it passes from a deceased who died domiciled in Ontario to a beneficiary who is resident or domiciled in Ontario. This obviously discriminates unfairly between estates which own such foreign real property and those which do not. It may also be conducive to tax avoidance in some circumstances. For example, an individual domiciled in Ontario could borrow money in Ontario and use the proceeds of the loan to purchase real property in Alberta or some other tax-haven jurisdiction. He derives a two-fold advantage from such a transaction, since the amount of the loan is deductible in computing the value of his taxable estate and the foreign real property is not included in his taxable estate.

As a matter of constitutional law, we have no doubt that Ontario is entitled to extend the present Section 6(b) to cover both real and personal

property situated outside the province. The exclusion of real property from the scope of Section 6(b) appears to be based less on the real or supposed constitutional incapacity of a province to tax such property than on the view that only the jurisdiction in which real property is situated should tax it on the owner's death. This view prevailed until quite recently even in jurisdictions with unlimited taxing powers. However, the federal government (which has unlimited taxing powers under Section 91(3) of the British North America Act) abandoned this principle when it enacted the Estate Tax Act in 1958. Canada's example of taxing the foreign real property of a deceased dying domiciled in Canada was followed in 1962 both by the United States of America and by the United Kingdom. For Ontario to extend Section 6(b) to include real property situated outside Ontario would therefore be entirely in accordance with this development, and would coincide with legislation passed by other provinces.

The second, and much more serious, defect in Section 6(b) is that personal property situated outside the province of the deceased's domicile is not subject to succession duty when it passes from a deceased dying domiciled in the province to a beneficiary who is neither resident nor domiciled in that province. For example, if an individual dies domiciled in Ontario, leaving assets which are situated in Alberta to a beneficiary who is resident and domiciled in Quebec, neither Ontario nor Quebec will levy succession duties. While Alberta could tax such property, it has chosen not to do so; the Alberta government stated on December 29th, 1971 that it would not impose succession duties after the federal government vacated the estate tax field at the end of 1971.

As long as the Estate Tax Act was in force, these deficiencies in Section 6(b) were not particularly serious. Real property situated outside Ontario and belonging to a deceased who died domiciled in Ontario, as well as personal property situated outside Ontario belonging to such a deceased and passing to a beneficiary who was neither resident nor domiciled in Ontario, were subject to full rates of federal estate tax, without any provincial tax abatement under Section 9(1) of the Estate Tax Act. Accordingly, the fact that such assets were not subject to Ontario succession duty did not create major tax loopholes, since the saving in provincial duty was compensated to some extent by an increase in federal estate tax. However, now that the Estate Tax Act has been repealed, these loopholes have become increasingly serious, particularly having regard to the much greater degree of taxpayer sophistication which can be expected to exist in the 1970's.

Merely expanding Section 6(b) to include foreign real property would not eliminate the second of these defects, which arises wherever the deceased and the beneficiary are in different provinces. In principle, there are only two possible methods of dealing with this problem:

The most desirable method would be to levy duty on all property, both real and personal, which passed from a deceased who died domiciled in the province to any beneficiary, whether or not he was resident or domiciled in the province. The Committee has given careful consideration to the views of a number of authorities on constitutional law concerning the constitutional basis for this type of taxation, which is sometimes referred to as taxation on "successions". It has been strongly persuaded by the view expressed to us after careful consideration by the Deputy Attorney General of Ontario. It was

his view that the Canadian courts would likely hold it to be unconstitutional for Ontario to seek to levy duty where property situated outside Ontario passed from a deceased who died domiciled in Ontario to a beneficiary who was neither resident nor domiciled in Ontario. We think that it would be appropriate for Ontario to seek a constitutional amendment in order to permit provincial taxation of such successions. However, until the British North America Act is changed we must accept its limitations.

Accordingly, reliance must be placed on an alternative approach, under which a beneficiary who is resident or domiciled in the province is subject to tax on his inheritance of property, both real and personal, which is situated outside the province, whether such property was owned by a deceased who died domiciled in the province or elsewhere. The opinions which the Committee has received indicate that such a tax, on what is sometimes referred to as an "accessions basis" is undoubtedly valid constitutionally. If Ontario is entitled to levy an income tax on residents of Ontario in respect of their foreign income, (which is indisputable), it is also entitled to levy succession duty on such residents in respect of their inheritances of property situated outside Ontario. This type of tax is often called a tax on "accessions". The Atlantic provinces, Manitoba, and Saskatchewan recently chose to tax such inheritances as the only acceptable alternative to continuation of the serious defects mentioned above.

Obviously, there are practical enforcement problems involved in administering a tax which is levied on an accession basis. Since all transactions presently taxed as "transmissions" under Section 6(b) of the Ontario Act

will continue to be taxed as "accessions," no greater difficulty will arise with regard to such transactions than has existed heretofore. Enforcement problems will arise when residents of Ontario inherit property situated outside Ontario from deceased persons who die domiciled outside Ontario. This is a situation which may make it difficult for the Ontario taxing authorities to find out about the inheritance. However, it should be no more difficult to enforce this aspect of the succession duty system than to collect income tax on foreign income earned by an Ontario resident. Arrangements for the exchange of information relating to estates among the provinces of Canada will be helpful in improving enforcement; fortunately, a number of other provinces have already indicated their willingness to exchange such information and we are hopeful that all the provinces which levy succession duties will co-operate, in their mutual interest. In addition, it would be very helpful in the Ontario context to make similar arrangements with foreign countries, with the assistance of the federal government.

DOUBLE TAXATION

The Committee recommends that foreign tax credits should be granted in respect of all foreign death taxes levied on property situated, according to Ontario law, in other jurisdictions. Ontario should seek federal assistance to negotiate death tax conventions with the United States and other major jurisdictions.

The dual nature of succession duty laws, which tax both property situated within the province and persons resident within the province, inevitably creates serious problems of double taxation. For example, if property situated in Quebec and owned by an Ontario deceased passed to a beneficiary who was resident in Ontario, duty would be levied by both Ontario and Quebec.

This double taxation problem is resolved by a type of foreign tax credit under Section 9 of the current Act, whereby Ontario makes an allowance in respect of the duty levied by Quebec on the property situated in Quebec. The principle underlying Section 9 is highly desirable; it ought to be the policy of Ontario to avoid double taxation in inter-jurisdictional matters.

We consider that since Ontario asserts a primary right to levy succession duty on property situated, according to Ontario rules, in Ontario, it cannot, in fairness, deny a similar right to other jurisdictions in which property belonging to a deceased who died domiciled in Ontario may be situated, again according to Ontario rules. Accordingly, tax credits should be granted by the statute for foreign taxes levied by foreign jurisdictions or their political subdivisions in respect of property situated, according to our rules, in such jurisdictions. Such tax credits should be limited to the lesser of the foreign taxes on such property and the Ontario duty on the resident Ontario beneficiary in respect of the same property.

Section 9 presently permits a foreign tax credit where an order-in-council names a jurisdiction. There is some thinking that such orders should be passed on the basis of reciprocity. In the Committee's opinion, it is wrong in principle to require reciprocity as a condition of granting foreign tax credits. When another jurisdiction refuses to grant a foreign tax credit in respect of property situated in Ontario and belonging to a deceased person dying domiciled in its jurisdiction, it must bear the wrath of its citizens for such double taxation, and its lack of a decent respect for the rules of

civilized international comity affords no reason for Ontario to deny a foreign tax credit. For Ontario to take the position, merely because the jurisdiction in which the foreign property is situated will not grant a similar credit on a reciprocal basis, merely would punish Ontario citizens without furthering the cause of reciprocity.

Adoption of the proposal will not wholly resolve the double taxation problem. If, for example, a person dying domiciled in Illinois left property situated in the Bahamas to an Ontario resident, Ontario would levy duty on the beneficiary under our proposal (for an accessions tax). Ontario would grant credit for any death taxes payable in the Bahamas where the property is situate, in respect of this property. But it would not grant any credit for U.S. federal or Illinois taxes. That is, Ontario generally acknowledges, and the statute we propose will recognize, the prior right of the jurisdiction of situs to tax the property. But Ontario has not heretofore accorded priority to or recognized the right of the jurisdiction of the deceased's domicile or citizenship. The solution to this problem requires negotiation of suitable tax conventions with the United States and other major jurisdictions. It is to be hoped that the federal government will co-operate in the negotiation of such conventions. Ontario should seek to negotiate in respect of the following matters:

- (1) Where movable or personal property is situated in Ontario and the

deceased and the beneficiary are both neither resident nor domiciled in Ontario but in the foreign jurisdiction, Ontario will exempt the property from duty in exchange for a reciprocal concession.

(We are hopeful that the U.S. will accept this proposal, since it has recently negotiated several treaties utilizing this principle of reciprocal exemption, which was recommended in 1966 by the Fiscal Committee of the OECD.)

- (2) Where the above exemption does not apply and where both Ontario and the foreign country seek to impose tax on property situated in a third jurisdiction, Ontario and the foreign country should each abate their taxes proportionately, in order to ensure that the total of the two taxes does not exceed what would otherwise be the higher tax. (We can also be hopeful that at least the U.S. will accept this proposal, since it is similar to the present Article V(2) of the Canada-U.S. Estate Tax Convention.)

Since this matter is of considerable urgency, the co-operation of the Canadian federal government should be enlisted as soon as possible. The federal government should be more than willing to undertake the negotiation of such conventions and agreements in view of its strongly held position that provinces should not enter into negotiations or agreements with foreign governments, the exclusive right to negotiate being vested in the federal government. The federal government is currently obliged to treat on such questions in connection with its own tax laws and could conveniently include the Ontario concerns among the matters to be negotiated.

VII

EXTENDED DEFINITION OF TAXABLE TESTATE

The Committee suggests adoption and definition of the term "property of the deceased" in lieu of "property passing on death", using the extended meaning as set forth in the federal Estate Tax Act with minor modifications.

It is characteristic of all systems of inheritance taxation that they tax not only property actually owned by the deceased at the date of his death, but also other forms of property which the Legislature considers are sufficiently similar to property actually owned by the deceased. Some types of property or transactions are also included in order to forestall certain methods of tax avoidance. It is not at all surprising that the lists of property and transactions which are included in various inheritance tax statutes differ significantly; argument by analogy is always dangerous in law - what to one person seems very much akin to property actually owned by the deceased may seem to another to bear no resemblance at all.

Ever since the U.K. Finance Act of 1894, inheritance tax legislation in the Empire and Commonwealth has used the expression "property passing on death" to describe the subject matter of taxation. It is clear from British cases interpreting this phrase that it includes more than property actually owned by the deceased at the time of his death; for example, property is said to pass on the death of the life tenant of property settled by someone other than himself. It has not been the practice of any Canadian taxing jurisdiction to assess tax in this manner without express statutory authority, but there has been a great deal of academic discussion in Canada as to whether the taxing authorities could maintain such a position under the various Canadian statutes. There seems little purpose in continuing to use the expression "property passing on death" when it is not intended to rely upon the British cases which give it an extended meaning. Accordingly,

Ontario would be well advised to follow the lead of the Atlantic Provinces, Manitoba and Saskatchewan, which have now enacted legislation which taxes "property of the deceased" including property which is deemed to be property of the deceased.

The enumeration of items in Section 3(1) of the former Estate Tax Act, which represents a much more recent compilation than that contained in the Ontario Succession Duty Act, is familiar to most Canadians who have an interest in the estate planning field. Accordingly it would be reasonable for Ontario to use this list as the basis of its legislation. In doing so, it will benefit from the dozen or so years of litigation in which some of the key provisions have already been interpreted. However, we have noted the technical changes which have been made by the Atlantic Provinces, Manitoba and Saskatchewan, which have modified this enumeration in several important particulars.

The balance of this discussion is therefore based on the enumeration in Section 3(1) of the former Estate Tax Act.

The property which a deceased actually owned at the time of his death is not intended to be caught by any of the items of the enumeration since it is already included in the plain meaning of the words "property of the deceased" where these appear in the basic charging provisions.

(a) Property of which the deceased was competent to dispose

Oddly enough, there is no provision in the Ontario Succession Duty Act which deals directly with the subject matter of this provision, although certain instances are dealt with specifically.

For example, in defining "property passing on the death of the deceased" the present Act includes general powers of appointment in subclause (ix) of clause (r) of section 1, and the following subclause (x) includes trust property where the settlor has retained power to reclaim it.

The expression "property of which the deceased was competent to dispose" is intended to refer to property which the deceased did not actually own in a legal sense, but which he could deal with in substantially the same manner as if he were the actual owner.

The chief example of this is the possession of a general power of appointment which enables the donee of the power to appoint to himself or to the world at large. Such a general power is included by Section 3(4)(a) of the former Estate Tax Act in "property of which a deceased is competent to dispose", but consideration will have to be given to the definition of the term "general power". The reference in the former Estate Tax Act suffers from three basic defects.

First, it does not include a power which is exercisable in a fiduciary capacity, even though the donee of the power may be entitled to exercise it for his own benefit. It would be more sensible if the definition were extended to include a power which is exercisable in a fiduciary capacity, but only to the extent that, having regard to the fiduciary restrictions, the donee can be said to be capable of exercising it for his own benefit. (Language for this purpose is included in the uniform Acts' definition of "general power", such as Section 1(o) of The Succession Duty Act of Manitoba, S M 1972, chapter S-215.)

Second, a power which is exercisable jointly by two or more donees (otherwise than in a fiduciary capacity) which can be exercised in favour

of one of these donees ought properly to be excluded from the definition of a general power, if the other donee or donees of the power has or have an adverse interest which would be prejudicially affected by the exercise of the power in favour of the first-named donee. However, there seems little reason why a general power conferred jointly upon A and B, enabling them to exercise it in A's favour should not be regarded as a general power if B has no "substantial adverse interest" and can therefore be reasonably expected to go along with A's wishes. For this reason, the uniform Acts have generally followed the American legislation in including such a joint power within the definition of a general power.

A joint power exercisable in a fiduciary capacity should not be included, since it seems too remote from the normal concepts of property.

Third, a power of encroachment on capital and a power to require an advance of capital, are not presently included as general powers by the terms of the Ontario statute, although they ought clearly to be included in the statutory definition, whether or not they are exercised.

(b) Donationes mortis causa.

There seems to be no dispute about the inclusion of this item in its present form.

(c) Absolute gifts made within three years of death.

The Committee recommends a draw-back period for inter vivos gifts of three years unless The Gift Tax Act, 1972 is repealed, in which event it should be longer.

The Ontario Act deals with inter vivos gifts in an unusual manner, by first including them in Sections 6(c) and (d), irrespective of the period of time which elapsed between the date of the gift to the date of death, and then excluding absolute gifts made more than five years before death under Section 5(1)(g). The recent decision in Re McCreath (1973) shows that the

the present form of exclusion can produce anomalous results which would be avoided if Ontario followed the form of the former federal provision. It is recommended that Ontario adopt the three year period as well in the interests of ease of administration. If Ontario saw fit at any future date to repeal its gift tax legislation, the throw-back period might have to be extended.

In Chapter VIII - "Valuations", under the heading "Valuation of Dispositions", we have recommended that dispositions be valued as at the date of the dispositions. This change is consistent with the change suggested herein.

As in the present Ontario statute, the statutory throwback should include the amount of gift tax paid together with the value of the gift as at the date thereof.

(d) Gifts including retention of benefit or control

The present Ontario Act, the Federal Estate Tax Act and the succession duty legislation of the Atlantic Provinces, Manitoba and Saskatchewan all reproduce a well-known provision in the U.K. Finance Act, 1894. The inadequacies of these provisions have become apparent as a result of litigation during the last thirty years. As the Privy Council has interpreted them, there need be no element of financial benefit or even of control of the donated property arising from the arrangement between the donor and donee in order for these provisions to operate. For example, a gift had been made of a farm property and, some time after the gift, a partnership was formed between the donor and the donee for the purpose of carrying on farming operations on the farm; on these facts, the Privy Council held, in Chick vs. Commissioner for Stamp Duties (1958) AC 435, that the donor had not completely divested himself of the donated property.

It is extremely difficult to decide on an appropriate provision to deal with this question. This Committee has agreed that the retention of possession by the donor as trustee for the donee should not be regarded as coming within the provision; this would involve no change in the legislation, since it has already been interpreted in this manner by the Privy Council in Oakes vs. Commissioner for Stamp Duties (1954) A.C. 57.

The Committee has also agreed that the mere fact that the donor, in his capacity as trustee, is entitled to apply in Court for remuneration in respect of his trusteeship should not be regarded as coming within this provision. It is suggested that, since retention of possession by the donor in his capacity as trustee for the donee should not be regarded as offending the provision, it would be reasonable to restrict the provision in order that it deal only with the retention of some actual financial benefit arising from the donated property. That is, by eliminating one of the arms of the provision, the line of judicial authority represented by the Chick case could be eliminated. The State of Victoria in Australia has dealt with this problem in Section 7(1)(d) of its Probate Duty Act and draughtsmen might well have regard to this precedent.

Finally, benefit should be defined to exclude fees paid to the donor as solicitor or other agent retained by the trust pursuant to powers therein reserved where the fees are fixed by a court or regulated by the custom of a trade or profession.

(e) Reservations of Life interests and Powers of Revocation.

There are two types of situations dealt with in this clause of the Estate Tax Act and examples of each will be given. First, if a person settles property in trust to himself for life, with remainder to his children,

the first branch is applicable. Second, if he settles property in trust, to pay the income to his wife during her lifetime, with remainder to their children, but reserves to himself a power to revoke the trust and to restore the property to himself, the second branch is applicable.

The second case deals only with situations whereby the deceased has reserved to himself alone the right, by the exercise of any power, to restore the settled property to himself. Under the former Estate Tax Act, if the power to restore the property to the settlor was vested jointly in the settlor and one or more other persons, the provision was inapplicable. The Atlantic Provinces, Manitoba and Saskatchewan have therefore departed from the Estate Tax Act provision by including situations in which power to restore the settled property to the settlor is vested jointly in the settlor and one or more persons, as well as situations in which the trustees are given power to restore it to the settlor. These changes in the second branch represent an obvious improvement.

This provision should also tax settlements in which the settlor has reserved to himself a right to designate at a later date the beneficiaries of the settlement or their shares of income or capital. However, it would be unwise to tax merely because the settlor, whether acting alone or with others, retains the power to fix the vesting date or payment date even though this may sometimes amount to a change in beneficial interests.

(f) Jointly-Held Property.

The Committee recommends the taxation of jointly-held property in terms of beneficial interest rather than in terms of contribution.

Under the laws of Ontario, Quebec and British Columbia a contribution test is employed in taxing jointly-held property. For example

Section 1(r)(i) of The Ontario Succession Duty Act includes in property passing on the death of the deceased:

any property held jointly by the deceased and one or more persons and payable to or passing to the survivor or survivors, except that part of such property which is shown to the satisfaction of the Minister to have been contributed by the survivor or survivors, provided that where the joint tenancy or holding is created by a person other than the deceased and the survivor or survivors, such property shall be deemed to have been contributed to equally by the deceased and the survivor or equally by the deceased and each of the survivors.

On the other hand, Section 3(1)(f) of the Estate Tax Act required the inclusion in the aggregate net value of "property held jointly by the deceased and one or more other persons, to the extent of the beneficial interest therein arising or accruing by survivorship or otherwise on the death of the deceased". This test is referred to as the "ownership" test.

Opinions may reasonably differ on whether the "ownership test" used for jointly-held property in the Estate Tax Act and the uniform Succession Duty Act or the "contribution test" used by the provinces of Ontario, Quebec and British Columbia is more equitable. However, there are three practical advantages in using the "ownership test":

- (1) Most Canadian taxpayers are familiar with the "ownership test" used in the Estate Tax Act.
- (2) The "ownership test" is easier to administer, since it avoids lengthy investigations into the source of funds used by individuals to pay for property acquired many years before the death.
- (3) Only the "ownership test" is compatible with the imposition of provincial gift tax. For example, if in 1972 a father

purchases property in joint tenancy with his son and the father pays the whole cost of the property, he will be deemed, for gift tax purposes, to have made a taxable gift to his son of one-half of the value of the property; it would be entirely unreasonable if, at the date of his death, the whole value of the jointly-held property were subject to succession duty.

In practice, the estate tax provision has been interpreted both by the administration and the courts as meaning that where two individuals held property as joint tenants, on the death of one of them one-half of the value of the property was to be included in computing the aggregate net value of the property passing on his death. However, at common law, each joint tenant of property is regarded as the owner of the whole property. Accordingly, it is probable that, on the death of a joint tenant, the legal nature of the interest of the surviving joint tenant does not change, even though it becomes more valuable, and that no beneficial interest can be said to arise or accrue to the surviving joint tenant as a result of the death.

While this view has never been dealt with by our courts, obviously it could, if adopted, destroy the whole intent of section 3(1)(f) of the Estate Tax Act. Accordingly, the provision in the uniform Acts is intended to preserve the same result as that which in practice was applied under the Estate Tax Act; the uniform Acts use the expression "property held jointly by the deceased and one or more other persons to the extent of that part of the full value of the property arrived at by dividing the

full value thereof by the number of joint owners or holders alive immediately before the death of the deceased."

This Committee recommends that jointly-held property should be taxed on an ownership basis, and that the newer provision be adopted. It also recommends that foreign real estate problems be minimized by declaring that tenancy by the entirety is a species of joint tenancy and can be dealt with as such.

(g) Community of Property.

The Committee recognized its limitations in making any recommendations on this matter at this time, having regard to the current, indepth study by the Ontario Law Reform Commission. The report of that Commission may well render unnecessary any serious study by the Advisory Committee.

The Committee is concerned with the obvious tax advantages accruing to persons in community of property, even where all of the property was acquired in Ontario. The Smith Committee was also aware of the problem and expressed its concern as follows:

"The result of this allowance is that a considerable tax advantage is frequently gained by those whose marriage is subject to community of property laws. On the other hand, it is likely that the existence of community of property is brought to the Treasury's attention only when a reduction in tax results. Certainly a good case can be made for giving a generous exemption to property passing to a succeeding spouse, as a means of providing for future needs, and of recognizing the partnership of a couple during the years of marriage. We do not believe, however, that recognizing community of property for the relatively few persons

in that position is a satisfactory way of achieving this objective. We therefore recommend that:

For the purposes of The Succession Duty Act, property held in community that was contributed by the deceased be deemed to be property passing on death..."

It is the present practice of the Department to recognize the existence of community of property when proof is submitted, and to assess only the interest of the deceased therein under The Succession Duty Act. The Committee suggests that the Act specifically provide for this practice to continue with the onus clearly upon the surviving spouse to show the extent to which, under the laws of the particular community of property regime, community assets should not be taxed in the estate of the deceased.

(h) Transactions for Partial Consideration

The time for valuation of transactions of this nature under the Estate Tax Act was the date of the transaction, rather than the date of death. We recommend the adoption of this rule and the use of the language of the Estate Tax provision.

(i) Private Annuities

Section 3(1)(h) of the Estate Tax Act required the inclusion in property passing on death of property that had been disposed of by the deceased in return for a private annuity.

The effect of section 3(1)(h) of the Estate Tax Act, when read together with section 4(2), was that where property has been disposed of by the deceased during his lifetime in return for an annuity, if the annuity to be paid did not exceed 5% of the value of the property transferred, the property was deemed to have been acquired by the purchaser without

consideration. If the annuity exceeded 5% of the value of the property transferred, then the annuity payments actually received during his lifetime were added together, less 5% per year of the property transferred, plus interest on each amount of excess over 5% from the time of payment to the date of death, and these amounts were regarded as forming the consideration which was deemed to have been paid for the property.

A similar, but slightly simpler, method has been adopted under the uniform Act. The mathematics set out in Schedule II to the Act may appear rather formidable but are not upon examination. The theory used in the formula is that the element of the private annuity that can be regarded as having been purchased for consideration is equal to the cost of an annuity of the full amount at the given age, less the value of a life interest at the given age in the total amount given less what is used up by the purchase. The example given in the Schedule is that of a person 85 years of age who disposes of property worth \$80,000 under an arrangement whereby he is to receive an annuity of \$6,000 for his life. Assuming that the present value of an annuity of \$1 per year for such a person is \$3.52, the formula can be expressed as $Y = (3.52 \times \$6,000) - 3.52 \times .05 \times (\$80,000 - Y)$. When this equation is worked out, it will be found that Y, the consideration deemed to be paid for the property disposed of, is \$8,543.69.

We recommend following the uniform Act provision, rather than the Estate Tax Act provision.

(j) Buy-Sell Agreements

The Committee recommends that the fair market value of property of the deceased sold after his death pursuant to an agreement entered into during his lifetime at arm's length and in good faith will be deemed to be the price payable under the agreement, provided the agreement is uncontested as between the two parties when exercised.

Frequently the shareholders of private companies or the partners of unincorporated businesses enter into what are commonly referred to as buy-sell agreements to provide for continuity in ownership in the event that one shareholder or partner dies or retires. Buy-sell agreements are also used by organizations owned by those active in the business to ensure that the respective interest of each partner in the ownership of the business is adjusted periodically to reflect his current contribution to its success. Typically in arrangements of this kind, partners or shareholders are finally bought out at the agreed prices prior to or shortly after retirement. In these circumstances no unusual tax consequences result. However if a partner or shareholder dies possessed of an interest in the business, duty under sections 1(r)(xiv) and 1(r)(xv) will be payable on the difference between the "value" of his interest and the amount his estate is entitled to receive under the agreement.

We see no need for such an arbitrary rule. Accordingly we recommend that the price payable under such an agreement be accepted as the fair market value for duty purposes.

Before making this recommendation we considered the possible situations where the acceptance of our recommendation could result in abuse. If the vendor has a personal interest in bestowing a benefit upon the purchaser - for example where a father agrees to sell the family business to his son at a favourable price, the price stipulated in the agreement should be subject to challenge. For this reason we suggest that the rule apply only to agreements made at arm's length. For further protection to the Revenue we suggest that the agreement must be uncontested when exercised.

If these conditions cannot be met then and only then should value be determined under the general fair market value rule.

These provisions should also apply to options - that is agreements where the proposed purchaser has the right, but not the obligation to acquire the shares of the deceased. A difficult valuation problem could arise if the option is not exercised immediately after death but is exercisable in the future. We suggest however that such situations are not incapable of solution and that, subject to the condition that the agreement be at arm's length and uncontested, the value of the optioned shares at death can be determined at a price which recognizes the existence of the option.

A major defect in what is now section 1(r)(xv) of the Ontario Act was revealed by Re Odette (1965) 2 OR 713 which held that an option which is exercisable during a fixed period without reference to the optionor's death was not affected by this provision. Where such an option or other right is outstanding at the date of death, and where it has been granted in a non-arm's length transaction, it ought to be taxed in similar fashion to options which are exercisable according to their terms on or after death.

(k) Annuities or other Interests purchased or provided by the Deceased

The British Courts have given an extended meaning to the words "other interest", rather than restricting it to interests similar in nature to an annuity. The essence of the provision, according to the British cases, is that an interest is said to arise or accrue whenever the beneficial interest of the beneficiary in the property in question changes in legal nature as a result of the settlor's death. If, for example, S settled property on T in 1950 to distribute the property among such of S's children as were alive at

the date of S's death and if S died in 1971, Section 3(1)(j) of the Estate Tax Act would have applied, even though S had not retained possession of any financial benefit from the settled property. The British case law under the comparable provision of the U.K. Finance Act, 1894 has emphasized esoteric features of property and trust law which have no proper place in a taxing statute designed to raise revenue on the basis of economic realities.

The present Ontario legislation is actually ineffective, since the Ontario statute has no provision similar to Section 3(7) of the former Estate Act enacted as a result of the decision of the Exchequer Court in Bassett Estate v M.N.R., (1962) C.T.C.23. (In this case the property was held to be taxable since an interest in it arose or accrued on the death of the deceased but the Court held that the property concerned was to be valued as the difference between the value of the beneficiary's interest therein at the point before death, and its value immediately after death. In the circumstances the difference was a scintilla of no measurable value.) It is recommended that at the same time as the Ontario provision is rendered effective, it should also be restricted in scope by deleting the expression "annuity or other interest" and replacing it with the expression "annuity or other income right", as has been done by the Atlantic Provinces, Manitoba and Saskatchewan.

(1) Death Benefits Payable under Pension Plans

The present Ontario provision is very similar to Section 3(1)(k) of the former Estate Tax Act, but absolute identity of the provision would eliminate some doubts which exist with the present Ontario language. It is recommended that the Ontario provision be modified to bring it in accordance with the former federal provision.

Apart from group life insurance which is more appropriately dealt with in conjunction with life insurance generally, there are still some forms of insurance owned or maintained by an employer on the life of an employee which should be treated as employee death benefits, as was done in section 3(8) of the Estate Tax Act. However, this provision should be redrawn along the lines of the uniform Acts. (See for example, section 4(5) of The Succession Duty Act of Manitoba.) This revision eliminates the problem illustrated by Wisener Estate v M.N.R. 71 DTC 29,* of a policy being caught by reason of its original ownership by the employer of the life named despite the fact that thereafter it had been assigned for value to a third party owner.

Deductions in relation to Non-Commutable
Annuities and Canada Pension Plan Benefits

The Committee considers that the present exemption (and deduction from aggregate) under section 5(1)(h) of the Act, relating to non-commutable annuities is unjustifiable in principle and should not be continued in a new Act.

A dependant who has been provided with a value of benefits derived from the deceased in excess of a generous dependant's exemption should pay tax on the excess, at initially low rates which ascend as the excess beyond the dependant's allowance increases. Anomalous special exemptions (whether for non-commutable annuities or for Canada Pension Plan benefits, as under the legislation of some provinces) working independently of any general scheme of dependants' allowances tend to benefit the wealthy who make use of them for tax avoidance, rather than the poor, or the average, who are protected in any event by the ordinary exemptions.

* Although the Wisener case was reversed on appeal, the general problem remains.

For example, take the case of a widow whose sole benefits from her late husband's estate are the \$30,000 family home, and a \$10,000 per annum lifetime pension. She is now, and under the Committee's recommendations will continue to be tax exempt. A much less fortunate, but more typical widow left with only the home and her survivor's benefit under the CPP will also escape taxation by a very wide margin through the ordinary widow's allowance.

But the Committee notes that such an annuity or survivor's benefit might also be imagined as an extra benefit received by a widow whose other benefits from her husband's estate equate or exceed the dependant's allowance for widows. The Committee says that in these circumstances the annuity or CPP benefit should be as taxable as any other benefit which might be provided to her.

It is just such anomalous exemptions as that provided by Section 5(1)(h) which make tax planning to minimize or even eliminate Ontario succession duty so rewarding an exercise for the affluent and their advisors.

(m) Voluntary Benefits

A provision dealing with voluntary benefits, as, for example, Section 3(1)(1) of the Estate Tax Act is obviously necessary in order to deal with death benefits which are payable under pension plans which confer no enforceable legal rights on the beneficiaries. However, because the present provision is much broader in scope, considerable difficulties have arisen in applying it, particularly in the cases of Robinson v M.N.R., 26 Tax A.B.C. 379 and Mulvenna Estate v M.N.R., 71 D.T.C. 199. It is recommended that this section be redrawn in order to confine its operation to payments made under plans or arrangements, whether or not enforceable by the survivor beneficiary, which were in existence at the date of the death, thereby excluding purely

ad hoc gratuities or pensions paid by a former employer to the dependants of a deceased employee, on the basis of their special financial needs.

Valuation of such benefits may be a problem. It is proposed to value such benefits as of the date of the payments thereof discounted in each case to the date of death at an appropriate interest rate.

(n) Life Insurance

The Ownership Test

The Committee recommends

- a) The existing "premium payment" test for determining the dutiability of life insurance proceeds be replaced by the test of ownership.
- b) Group life insurance payable on the death of the deceased be dutiable except to the extent that the proceeds are payable to and retained by the owner of the master group insurance contract, and
- c) Accidental death insurance or any other type of insurance payable by reason of the death of the deceased be dutiable where under a group or individually owned insurance contract.

Amounts payable as a result of the death of the deceased under an insurance contract are now dutiable in the proportion that the premiums paid by the deceased bear to the total amount of premiums paid on the policy. While this method has survived the test of time, we are not convinced that it represents a better method for taxing insurance proceeds than the "ownership test" first introduced in the federal Estate Tax Act and adopted by the co-operating provinces.

The ownership test offers the advantage of simplicity; ownership is easily established and does not require a review of premium

payments made over an extended period of time, a particularly difficult task when good evidence is no longer available. However the ownership test seems more appropriate for other reasons. First, as we have mentioned, the ownership test is now in effect in the six co-operating provinces. The addition of Ontario to this group will result in uniformity of treatment in all but two provinces in the succession duty field. Second, the ownership test appears to be more consistent in that its treatment of life insurance follows the general principle applied elsewhere in the statute that property should be subject to duty if it is owned by the deceased. Finally, we are concerned that the premium payment test creates anomalies made more severe because of the recent introduction of a gift tax.

For example Mr. A assigns an insurance policy on his own life to his son for no consideration. At that time, the value of the policy is determined and gift tax is assessed and paid. Thereafter Mr. A's son pays all of the premiums on the policy until Mr. A's death. In spite of the fact that Mr. A's son is the beneficial owner of the policy and gift tax has been paid on the full value at the time he acquired it, the premium payment test would still apply to bring a portion of the policy proceeds into Mr. A's estate.

We have concluded that an ownership test, based on an extended definition of ownership as in the uniform Acts and combined with a gift tax, is a fairer basis for duty, and therefore recommend its adoption.

Group Insurance

Group insurance is almost invariably arranged or provided by or in relation to the employment or membership of the life

insured. We therefore consider it both simple and reasonable to recommend that the proceeds of all group insurance payable on the death of the deceased should be included in the estate of the deceased except to the extent that such proceeds are payable to and retained by the owner of the master group life insurance contract.

Corporate Owned Insurance

The Committee recommends that insurance proceeds on a policy owned by a corporation controlled by the deceased be dutiable to the extent they are payable to persons related to the deceased. Proceeds payable to the corporation would be dutiable only to the extent that they exceed a reasonable provision for the loss of a "key man".

The Estate Tax Act and the uniform Succession Duties Acts deal, quite properly in our view, with situations where a corporation controlled by the deceased owns life insurance on his life payable to beneficiaries with whom the deceased does not deal at arm's length. However Section 3 (m)(i)(C) of the Manitoba Succession Duty Act, for example, includes insurance payable on a policy owned "by a corporation controlled by the deceased, the whole or any part of the amount payable to the spouse or child of the deceased ...". We think it unnecessary to include the full proceeds of the policy in circumstances where only a part is payable to the deceased's intended beneficiary. Therefore we recommend the inclusion of only the portion of the policy proceeds payable to the beneficiaries.

Insurance policies are frequently used by corporations to offset, at least in part, the loss of a key executive. The Estate Tax Act and the uniform Acts recognize this by imposing tax only on the portion of insurance proceeds payable to a corporation controlled by the deceased in excess of the last five years' net earnings.

We acknowledge that this formula may provide adequate protection for the loss of the keyman in cases where the corporation has been in business long enough to establish a reasonably stable earnings record. This is not always the case. Newly established companies may be operating at a loss and yet still require protection against the loss of a key man. In fact the need for insurance protection may be greater in these circumstances than it will be later, when the corporation has become better established. Also net earnings are a somewhat artificial measure in the closely-held company where the salary and profits are annually adjusted to achieve the best tax result.

Accordingly we suggest, as a better measure of the worth of the key man, that a mixed average be used. Thus the rule would be that insurance proceeds payable to a corporation controlled by the deceased would be included only to the extent that they exceed three times the aggregate of

- (a) the average annual net business income for the five completed fiscal years immediately preceding death, plus
- (b) the average annual employment income paid to the deceased in respect of those five years.

Definitions

As a matter of necessity or convenience the new statute will contain a large number of definitions. A few definitions of importance were considered by us as being appropriate cases for the insertion of a new definition or for amendment of an existing statutory meaning.

Definition of Child

The Committee recommends that the definition follow the definition of the word as it is set out in the uniform Act; provided however, that the Committee prefers the restriction of descendants posterior to children to legitimate lineal descendants. Further, the Committee tends to feel that in the case of the death of a woman her natural offspring, whether legitimate or illegitimate, should be deemed to be her children. This would accord with a concept in our law as old as Sir John Littleton.

Definition of Parent

The Committee is of the view that the person who stands in loco parentis to a child should be categorized as a parent.

Definition of Disposition

The Committee is of the view that a new definition of this term should be provided in a new Act. It should begin with a basic definition of a gift as, for example,

a gift is a voluntary transfer of property or an interest in property by its owner to another without the expectation or receipt of sufficient consideration, the insufficiency constituting a gift in an applicable case.

After such a basic definition the new Act should give an extended general definition very much like the definition now to be found in Section 1(12) of the Gift Tax Act.

Finally, the definition should provide that anything which is a gift for gift tax purposes should be a disposition for succession duty purposes.

Definition of Arm's Length

In a number of special cases under the Estate Tax Act the valuation of assets depended upon whether or not there was an arm's length relationship between the deceased and other persons. For example, the rule in section 29 did not apply where the deceased controlled the company, either alone or together with one or more persons connected with him by blood relationship, marriage or adoption, and section 31 dealt with the valuation of debts owing to the deceased by any person connected with him by blood relationship, marriage or adoption. In each case, certain arbitrary valuation rules applied unless it was established that the deceased and the other person or persons were persons dealing with each other at arm's length.

Although the concept of dealing at arm's length has been used in our federal Income Tax Act since 1948, considerable uncertainty still appears to exist as to the basic meaning of the expression. This uncertainty arises primarily because the English legal dictionaries use the expression "dealing at arm's length" as relating to transactions between parent and child, solicitor and client, doctor and patient, etc., where one party to the transaction is presumed to be in a position to exert improper influence on the other unless he "puts himself at arm's length", which usually means ensuring that the other party has proper independent legal advice. On the other hand, the concept of dealing at arm's length which is used in the federal Income Tax Act and which was used in the Estate Tax Act is of American origin, and the expression "dealing at arm's length" is defined in most American legal dictionaries

in a manner that more clearly reflects the intent of our tax legislation. In an attempt to reduce controversy, the uniform Act adopts, and we recommend for Ontario, a definition derived from Black's Law Dictionary, a well-known American work, as follows:

"For the purpose of this Act, persons shall be deemed to be dealing at arm's length when each stands upon the strict letter of his rights, and conducts his business in a formal manner without trusting to the other's fairness or integrity and without being subject to the other's control or overmastering influence."

It should be noted, however, that this provision is not an all-inclusive definition of dealing at arm's length; it is still open to persons to show that they are dealing at arm's length even though they do not comply strictly with the standards set out in the statute.

VIII

VALUATIONS

The general rule

The Committee recommends that value for duty purposes be defined simply as the "fair market value" of the property at the applicable date, and that the Ministry of Revenue release information bulletins, not having the force of law, to the professional community outlining among other matters the interpretations the Ministry proposes to place on the term for assessing purposes in common types of situations.

Section 3 of the present Ontario statute contains specific rules to be used in determining the "value" of a number of different classes of property. Section 3(1)(a) provides that the value of listed securities will be the closing market price on the date value is to be determined, unless the security in question is narrowly held so that the market price does not reflect "true" value, or where there is evidence of price manipulation or control. Section 3(2) provides that income taxes which may become payable on distributions of corporate surplus are not to be taken into account in the valuation of securities or other business interests unless such surplus distributions are necessary for the purpose of raising money for the payment of duty.

The Committee considers that, while these rules may have provided administrative convenience in the past in avoiding uncertainty or dispute, they no longer serve this purpose and are restrictive in the determination of value. Instead, "value" should be defined as the "fair market value" of the property at the date the determination is made.

In support of this view, it has been pointed out to us that the concept of fair market value is well understood in common law. Perhaps more to the point however is the introduction of the term without definition in many sections of the Federal Income Tax Act. For example, the Income Tax Act uses

the term "fair market value" to establish the "cost" of property owned at the date the new tax on capital gains becomes effective; and to determine the amount received as a result of the disposition of capital property which is deemed to take place at the time of death.

The Committee believes that sections 3(1)(a) and 3(2) can no longer be justified on the ground of administrative convenience alone. Indeed, it appears to us that Section 3(1)(a) establishes only the obvious - that market price reflects value except in circumstances when it does not. Since "fair market value" of property held at the time of death must be established for income tax purposes in most cases, we are opposed to valuation rules in the Succession Duty Act which would result in a different determination of value for identical property on the same date.

Section 3(2) which limits recognition of underlying income taxes in the valuation of business interest raises somewhat more complex issues perhaps best illustrated by an example.

Assume that Mr. A incorporated X Limited in 1960 and invested \$100,000 in the company for which he received the only outstanding shares. X Limited then purchased a piece of land for resale at a cost of \$100,000 and at the date of Mr. A's death it still held the land, then \$1,000,000, as its only asset. Since the land was held as a trading asset, any sale of the property would produce a corporate income tax liability, estimated at \$450,000, leaving X Limited with paid-up capital of \$100,000 and retained earnings of \$450,000. If we assume that Mr. A was in a tax bracket such that any dividends which he received from X Limited would be taxed at a net rate of 45.5% after all dividend tax credits (a rate imposed on taxable income in excess of \$60,000),

the distribution of these monies would result in further tax of \$204,750, leaving Mr. A with \$345,250 net after all income taxes have been paid. Clearly, in valuing Mr. A's shares at his death, recognition must be given to the corporate tax payable in respect of the profit that will be realized on the sale of the land by X Limited, that is the first \$450,000 of tax. But there remains the question as to what recognition, if any, should be given to the additional tax payable when the net realized profit is distributed to the shareholder in the form of a dividend.

A strict interpretation of section 28 of the former Federal Estate Tax Act would suggest that no recognition may be given to the tax payable on the distribution. The Ontario Succession Duty Act provides a somewhat less harsh treatment (but also one which is somewhat illogical) in that tax on the distribution may be deducted if and to the extent that a distribution is required in order to pay duty. However, both of these approaches suggest that the shares of a privately held company should be valued only by reference to its underlying assets. This is wrong in principle.

It is general practice to value businesses, including shares of limited companies, by reference to a number of criteria, including:

1. The earning power of the business, either based on past experience or on future prospects (value being determined by applying an appropriate multiple or capitalization rate);
2. Anticipated future cash flow, discounted to present value;
3. Commonly accepted "rules of thumb" for the particular industry, where a unit price per customer or per unit of sales volume has been established; and,
4. Current values of underlying assets.

The selection of the most appropriate method for determining value in a particular circumstance is a question frequently requiring the advice of professional evaluators and lengthy negotiations between the principal parties concerned. We believe that it will be preferable to leave this process unencumbered by a legislative rule which in any event properly applies only in circumstances where the last mentioned criterion is determinative.

Reverting to our example, the value of Mr. A's shares in X Limited should be determined by reference to the price which Mr. A should reasonably expect to receive from a willing purchaser should these shares be offered for sale at the date of his death. The term "fair market value" is, in our view, an adequate legislative rule to ensure this result.

The Committee has considered whether special provisions are required to protect the Revenue in circumstances where the deceased holds a controlling interest or a minority interest in the shares of a corporation as one of a group of related persons who together exercised effective control. It was concluded that if the fair market value is properly determined, recognition would be given to the question of control whether control is exercised directly or indirectly, hence no special provision is needed. The federal government has apparently reached the same conclusion since no provision similar to Section 29(2) of the Estate Tax Act has been included in the new Income Tax Act.

The Committee also considered whether it is necessary to deal specifically with loans made on a term basis to related persons. For example, the Succession Duty Acts recently adopted by some of the provinces provide that debts owing to the deceased by related persons at the date of death are to

be valued as if the debt were due and payable at the valuation date rather than the date the debt is in fact due. Presumably this provision presents the possibility of valuing a non-interest bearing term note at a substantial discount at the date of death. The Committee concluded that it will be preferable to continue the already announced policy of the Ontario Government which is to treat such benefits as gifts subject to the provisions of the Gift Tax Act at the time the obligation was first incurred. Accordingly, it is not necessary to deal with this matter under the Succession Duty Act.

In recommending the use of a general, rather than a detailed definition of value, the Committee recognizes that the public is entitled to know how the Succession Duty Branch will interpret the term. Of course, there will be a growing body of judicial precedent as to the meaning of the term "fair market value" as cases under the new Federal Income Tax Act, the Gift Tax Act of the provinces, and the Ontario Expropriations Act and Assessment Act come before the courts. Because of the similar terminology, these decisions will have a bearing on assessing practice. In addition, however, the Committee suggests that the policy statements which the Committee has recommended in Chapter X of this report include guidelines as to valuations.

One matter which has come to the Committee's attention could be dealt with in such a release. Generally, if property, other than marketable securities, is sold within a few months of death, one would expect that the price at which the sale takes place should have a strong influence in settling the fair market value of that property at the date of death for duty purposes. In these circumstances, some provision should be made for direct selling costs incurred but such is not the current practice of the Succession Duty Branch.

Where a sale does not in fact take place, it may be difficult to justify the deduction of an assumed cost which may not be incurred for many years from what is essentially only an approximation of the value of the property concerned. Where the property is sold, say within six months of death, the Committee believes that valuation should reflect the net proceeds rather than proceeds before direct selling cost if the sale price is considered to be the most appropriate measure of value. In case there is any doubt as to what is meant by direct selling costs, the reference is not to income tax or capital gains tax which may become due as a result of the sale, but only to direct costs incurred in making the sale such as selling agents' commissions and professional fees.

Valuation dates

In general, the only date which is relevant for the purpose of determining value is the deceased's date of death. However, the Committee has heard arguments in favour of alternative valuation dates in order to protect beneficiaries from the effects of a decline in the value of their bequests between the date of death and the earliest date that they are able to deal effectively with the property.

The problem can be severe if market values are declining rapidly. The counter argument is that such a proposal will result in some administrative complexity, and, somewhat ungenerously, offers little to the Revenue. If market values go up, the wise beneficiary will elect the date of death as his appropriate valuation date.

While the pros and cons of various alternative valuation date proposals could be debated at length, the Committee suspects that the problem which the proposal is intended to cure is rarely serious in practice.

The Committee concludes that the general rule should be fair market value at the date of death. The adoption of this rule should permit both the taxpayer and the Revenue to argue that market price changes around that date should be taken into account.

Valuation of dispositions

The Committee recommends that dispositions be valued as at the date of the disposition.

The general rule under the present Act is to value gifted property at the time of a donor's death. Gifts of money are valued at actual value, however, and property sold by the recipient of the gift, but prior to the donor's death is valued at the cash value realized on the sale. These rules suggest that the prudent donor will give cash rather than property which may appreciate in value. The intended gift may then be purchased with the cash. The Committee doubts that equity is served by the present provisions, and therefore recommends that dispositions be valued at the date the disposition becomes absolute.

Life insurance policies

The Committee recommends that life insurance policies assigned should be valued at their cash surrender value, including the value of any accumulated dividends, prepaid premiums and the proportionate amount of the last premium for any unexpired portion of the period for which the premium was paid, less the amount of any outstanding policy loans and unpaid interest thereon. If death occurs within one year of assignment, value should be presumed to be the policy proceeds in the absence of evidence to the contrary.

The Committee believes that a special definition of the value of a life insurance policy which has been assigned as a gift or for consideration is a necessary modification to the general recommendation that property be valued simply at its fair market value. This requirement arises because

concern is with the value of the policy at the date of transfer rather than at the date of death. The practical problem of establishing the fair market value at the date of assignment of a policy which the insured assigned several years before his death could be extremely difficult, particularly if his health was below par at the time of the assignment. To avoid this problem it would be necessary to have him medically examined at the time of the assignment, and an actuarial valuation would have to be made. In practice, it can be assumed that few will take these precautions leaving taxpayers and the Revenue to debate the state of the dead man's health at an earlier date when he was still alive. Clearly a simpler procedure should be established.

This leaves only the question of policies assigned in contemplation of death. However, it may be difficult to establish whether in fact the assignment was made in contemplation of death or whether death occurred unexpectedly. To avoid such controversy, an arbitrary rule seems to be indicated; if death occurs within one year of the assignment, value would be presumed to be the policy proceeds in the absence of evidence demonstrating that some lesser value is appropriate.

Interest and mortality

The Committee recommends use of a 5% interest factor and the Canadian Life Tables 1965-1967 with separate tables for males and females.

The present Act imports into actuarial computations, required for valuations, and the scheduling of tax payments, the use of a 4% interest assumption, and 1937 annuity tables based on male lives. These assumptions are inappropriate in 1973.

Interest assumption

In connection with interest, the Committee recognizes the force of the arguments for flexibility and the bias involved when the rate becomes unrealistic. But the Committee notes the slowness of the public to adapt to new law, and the value of legal certainty in estate planning. It also notes the problem of annual re-printing and distribution of tables. These considerations lead the Committee to suggest a rate fixed by statute, or by regulation with some statutory restriction or discretion, and kept unchanged until it becomes markedly unrealistic.

The Committee recommends for this purpose a 5% interest assumption having regard to the Gift Tax Act where it is used, and the Acts of other provinces.

Perhaps 6% or 6½% would be a rate more closely related to the current yield on long-term investments. The mix of estate assets, however, and the need to balance the income interests of life tenants against the growth interests of remaindermen suggest a lower rate. (The lower the rate, the greater is the yield to the Revenue, since low rates undervalue, in strict terms, the lightly taxed interests of life tenant widows, and similarly overvalue the interests of more heavily taxed children.)

Mortality tables

The justification for the current use of an Annuity Mortality Table rather than a population Mortality Table is unclear. The present table, the 1937 Standard Annuity Table, is derived from the statistics of people who purchased annuities from insurance companies who presumably enjoy better health and lower mortality than the national average due to "self-selection." Since those who pay Succession Duty are unselected as to

health (except possibly because they belong to a particular income class) a population mortality table is more appropriate.

The 1937 Standard Annuity Table is rarely used by actuaries today because more modern tables are available. In addition, the table appears to be distorted, giving unreasonably high expectations of life at the older ages.

The mortality of Males and Females is so different that it is unsound to use one table for both sexes. For example, the expectation of life at age 60 is 16.81 years for a male and 20.58 years for a female in the latest Life Tables for Canada.

Accordingly, the Committee recommends that the Canadian Life Tables 1965-1967 (separately for Males and Females) be adopted. These are the most recent commonly recognized tables.

Complete Expectation of Life

<u>Age</u>	<u>Present Basis</u>	<u>Proposed Basis</u>	
	<u>1937 Standard Annuity Table</u> <u>Males and Females</u>	<u>Canadian Life Table 1965-67</u> <u>Males</u>	<u>Females</u>
10	60.48	61.00	67.12
20	51.18	51.50	57.37
30	41.91	42.29	47.68
40	33.00	33.01	38.15
50	24.78	24.31	29.02
60	17.55	16.81	20.58
70	11.60	10.83	13.14
80	7.11	6.36	7.26
90	4.03	3.60	3.60

Since population mortality changes slowly, the Act need not provide for automatic revision to the mortality basis. The Act could be amended if life expectancies were to alter significantly.

IX

PROCEDURAL ASPECTS

The Committee recommends a system of two returns and that the second should be drawn so that consents to transfer can be photographically reproduced.

Time for Filing

Subsections 1 and 2 of Section 13 of the present Act provide for the filing of:

- (1) an affidavit from every beneficiary and donee within three months after the death of the deceased, containing an inventory of the estate and details of any gifts made, the names, addresses and relationship to the deceased of the beneficiaries, and
- (2) an affidavit from the estate executor or administrator, at the time of making application for a grant to the Surrogate Court, containing basically the same information as required above.

Subsection 3 of the Section provides that where the affidavit of the estate executor or administrator is filed within three months of the death of the deceased, the Minister may dispense with the filing of other individual affidavits.

Subsection 4 provides for a penalty in the sum of \$10.00 for each day during which any person in Ontario makes default in complying with the filing of the affidavits.

The Committee recognizes the apparent duplication involved in the present procedure and has been made aware of the considerable time and cost involved in compliance. The Succession Duty Branch has for a number of years accepted an abbreviated form of affidavit from beneficiaries and donees as complying with Subsection 1 and the Committee recommends that statutory recognition be given to this practice.

The concern was expressed to the Committee that in some instances consents to transfer assets were required before the estate

representatives were in a position to file the estate inventory, and that provision should be made to enable speedy consents to be obtained in these circumstances. In addition, the Committee was made aware of a conflict between the need to free the most liquid assets such as bank deposits and life insurance proceeds for the immediate needs of dependants, and the need to withhold desirable assets in order to induce compliance with statutory procedures. By law, certain limited sums may be paid by their holders to those entitled without consents, and in practice, the Succession Duty Branch will issue releases on the strength of a letter prior to the filing of the Affidavit of Value and Relationship, if the estate representatives show that assets remaining unreleased provide adequate security for any Succession Duty that may be payable.

However, a system could be devised under which two returns might be filed. The first would be a very simple return to be filed within one month of the death, containing a minimum of information but alerting the Department to any unusual matters of an emergency nature. This return, which could be completed and filed by life insurance companies or banks, would permit them to make payments within the statutory limits. The preliminary return would also permit the estate to alert the Branch early to the need to undertake valuations or other procedures of a time consuming nature.

The final succession duty return should be made within six months after the date of death, which would also be the time for payment of succession duty.

To simplify the administration and reduce departmental costs, it is recommended that the final return be in such a form as to enable a

copy of the declared estate inventory to be used as the Minister's consent upon processing on safety paper through automatic equipment in the Ministry. The advantages would be speed and economy at the expense of transferring to the applicant the responsibility for the proper completion of the consent. The practice in the Companies Branch of the Ministry of Consumer & Commercial Relations in the issuing of articles of incorporation proves that such a transfer of responsibility achieves economy and simplicity of administration and is likely to prove popular with applicants after a period of adjustment to their assumption of a responsibility which is really theirs, but which a paternal bureaucracy removed from their shoulders.

The Committee is advised that perhaps ten people per working day attend personally at the office for the purpose of being assisted with the completion of the returns and/or obtaining consents to transfer. It would therefore be necessary to make provision for such persons that they might have their returns completed in a manner which accords with requiring standardization.

PROBATE AND FILING FEES

The Committee recommends that:

1. Surrogate fees be a fixed fee of \$25.00 in respect to each application for probate or administration, which in effect is a processing fee only.
2. A filing fee be imposed on each filing of an Affidavit of Value and Relationship under The Succession Duty Act of one half of one percent of the value of assets declared thereon less \$25.00 deduction where an application to the Surrogate Court has been made or will be made, upon proof of payment of Surrogate Court fees.
3. No filing fee shall be levied where the total disclosed by the Affidavit of Value and Relationship does not exceed \$5,000.00.

In our terms of reference we were directed to "examine and report to the Minister of Revenue upon the relationship between the administration of The Succession Duty Act and The Surrogate Courts Act with the objective of avoiding duplication of costs in the administration of related statutes."

An itemization of assets and a statement as to their value must be submitted in connection with an application for a grant made to a Surrogate Court. While the itemization would be required for purposes of trust law generally, especially trustee accounting, the submission of values seems to be solely related to the fact that Surrogate Court fees, being one half of one percent, vary in proportion to the value. Since the Surrogate Court lacks means to verify such values in cases where, because the estate is not dutiable, information concerning values is not forthcoming from the succession duty administration, the Committee is convinced that the present system should be altered.

In the Committee's view the Surrogate Court should charge a flat fee for a grant just as the Supreme Court charges a flat fee for a writ or other process. The Committee presumes that the Ministry of Justice will set the flat fee in light of the cost of the service.

On the other hand, it seems appropriate not to forego the revenue involved in the present fee. Accordingly, it is suggested that all estates pay a filing fee at the time of filing the major death duty return based on the value of the estate of the deceased as thereby declared and subject to increase where the value is increased. The rate should be one half of one percent less \$25.00 upon submission of the receipt of the Surrogate Court. A small estate exemption might eliminate the fee where the return does not disclose value in excess of some minimal figure such as \$5,000.

It is not unrealistic to charge this fee in view of the very considerable amount of work involved in the succession duty administration whether or not the estate is taxable.

Time for Payment of Duty

The Committee recommends that duties in general be payable six months after death with two exceptions:

- (a) all beneficiaries should have the option to pay duties in monthly, quarterly or annual instalments over any period up to ten years, provided that interest is paid and security lodged;
- (b) income beneficiaries should have the option to pay duties over the terms of their benefit with interest on a fully amortized monthly, quarterly or annual basis with payments being calculated on the basis of the initially-assumed length of the term.

Two problems are posed by the present general requirement to pay succession duties within 6 months of the death of an individual with respect to the property passing to beneficiaries.

The first is that the property may not be readily realizable within 6 months. Examples would include the family farm and other large holdings of real estate, family businesses, blocks of securities for which there is no market, such as shares in closely held corporations or even those of large public corporations when the block is too large for the normal market in which these shares are traded, mortgages and other private debts.

The second is dutiable property which is a series of payments over time or which is a residuary interest not receivable until the life interest has terminated. In these cases, the present Act offers alternative payment schedules.

An annuitant or life interest beneficiary may at present spread the payment of duties over a maximum of ten years depending upon the nature

of the benefit, without interest. A beneficiary whose interest is postponed in enjoyment similarly may elect to pay duties when his benefit is received but if he does, the duties are based upon the value of the interest when he begins to enjoy it rather than upon its discounted value at the date of death. There is a further remedy in Section 23 which gives the Minister discretion to extend the time for payment.

The Committee believes that the Revenue should continue to expect payment in six months as a matter of general principle. However, the Act should provide universal flexibility where necessary on payment of interest at an appropriate rate. The Committee therefore recommends that all beneficiaries regardless of the nature of their interest, be given the right to pay duties in monthly, quarterly, half-yearly or annual instalments over a period not exceeding a period of ten years with interest on the unpaid balance at a rate to be prescribed by regulation with the first instalment to be payable six months after the death of the deceased and with reasonable security as arranged with the tax administration.

While the present relief for beneficiaries receiving annuities or lifetime payments is helpful, a more complete remedy should be adopted. The Ontario Committee on Taxation made recommendations, being Recommendations 28:10, 28:11, 28:12 and 28:13 which in turn were endorsed by the Select Committee under the Chairmanship of the present Treasurer. In essence, these recommendations permitted the beneficiary in receipt of this type of benefit to pay duties by instalments during the period of receipt based upon the term of the annuity or the life expectancy of the beneficiary. The instalment would cease upon the death of the beneficiary regardless of whether the duty payable as calculated at the commencement of these periodic payments had been satisfied or not. In the case of a life interest, the instalments would continue for life, however long. The Committee endorses these recommendations and urges that they be adopted.

In the event that a life tenant or annuitant dies prior to the end of the period of reassessment and before the deferred balance has been paid in full, duty on such interest or annuity shall be recalculated and in the case of a life interest, the remainder interest shall also be revalued, in both cases upon the basis of the life interest or annuity consisting of a right for a term certain. In the event that the death occurs after such period, but prior to the payment in full of the deferred balance, the unpaid balance should be forgiven.

Safety Deposit Boxes

Under the terms of the present Act, the safety deposit boxes of a host of relatively remote relatives of the deceased are supposed to be sealed, only to be reopened upon consent of the Minister. On the other hand, there is no provision for an administrative discretion which would allow the Revenue to insist upon the sealing of particular boxes.

The automatic sealing of boxes should be confined to those leased by the deceased and his spouse. But the Committee recommends that the customary affidavits demanded of all beneficiaries be expanded to include a declaration by the person or persons concerned that they held no assets on behalf of the deceased either directly or indirectly at the time of the death of the deceased or within a stated period prior to the date of death.

At the request of the Department such affidavits could be required from other persons, such as an officer of any corporation with which the deceased was connected, who may have had in its possession or control assets of the deceased.

Interest

Interest plays several roles under the Act, as when duty has not been paid when required, when duty is postponed as permitted, when refunds are made for duty overpaid and when a computation of the present values of postponed or income benefits is required to determine duty.

The Committee believes that in all such cases logic should govern government rate-setting. There should be no incentive, in the form of an unrealistically low interest charge, to postpone payment of duty when required by the Act. In such cases, the Committee recommends that the Treasurer, who should be given discretion to set the interest rate from time to time, should set the rate neither higher nor lower than existing general borrowing rates. The Committee hopes that this should be the only principle borne in mind in such fixing of rates. Penalty should not be an element, in that estates are often embarrassed by a lack of immediate liquidity.

When duty is postponed by election under the Act then the suggested principle is that the Revenue should receive similar interest as it must pay to borrow funds to replace the duty postponed. An appropriate guide to the appropriate rate would be the weekly index published by the Bank of Canada of the average of all long term Canada bonds or, alternately, the most recent rate of interest paid on 10 year borrowings by the Province prior to the time the rate is to be fixed. The rate should vary weekly or monthly but remain constant from the time of the election to postpone to apply thereafter to the particular duty postponed without variation.

Where duty has been overpaid and a refund is established to be payable the Revenue should not make a profit on the use of the money held and so the appropriate interest rate would be the same as that fixed in the preceding paragraph, with a higher rate, such as that first mentioned, where the overpayment is consequent upon an overassessment reversed on successful objection or appeal. Computation of present day values for succession duty purposes poses a different problem which we have dealt with under the heading "Interest and Mortality".

Debts of the estate

There should be no provision for solicitors' fees except of course any fees payable in respect of services rendered to the deceased prior to death. The present allowance bears no relation to the probate tariff which extends to services often rendered long after the death which is generally the cut-off point in relation to debts.

The Committee was also of the view that it should be made entirely clear that the income tax bill, representing the terminal fiscal period of the deceased including income taxes payable by reason of the deemed realization of capital property including depreciable property pursuant to the provisions of Section 70 of the Income Tax Act, or representing any prior periods, should be deductible as a debt, except to the extent it is otherwise creditable.

The Committee is of the view that the present provision for the deduction of reasonable funeral expense should be enlarged by regulation to set out what the expenses might include and what quantum is reasonable. It was the view of the Committee however that Ontario ought not to be moralistic about this and that all such expenses should be allowed where properly paid for the purpose as they cannot possibly benefit beneficiaries except in the odd situation where a beneficiary is the recipient of one of the disbursements. (This situation might be covered by an exception.) The defined expenses should, in the view of the Committee, include a monument and cemetery plot.

The present Act allows the deduction of the deceased's debts in the process of arriving at aggregate. Obvious loopholes require an expanded definition of a "debt" for this purpose. The present practice of the Revenue, which the Committee considers reasonable, as opposed to the present statutory language, should afford the basis of the new definition.

Method of Calculating rates

The progressivity of rates should be based upon either the size of the estate or the size of the inheritance but not both.

Where a beneficiary is entitled to be exonerated from duty out of a tax free fund, his rates otherwise calculated shall be increased.

Under the present Act rates are calculated taking into account the size of the estate, the size of the beneficiary's interest and the relationship of the beneficiary to the deceased. This system is inevitably more complex than choosing to base progressivity upon either the size of the estate or alternately the size of each beneficiary's inheritance. The Committee is quite clear that Ontario should do one or the other.

Members of the Committee argued among themselves as to which was the better basis. In the end, both sides of the argument accepted the point that the issue really does not matter very much. Conceptually, basing rates on the size of the estate represents a final taking of tax accounts giving the State an opportunity to redress inequities in the lifetime tax accounts. The inheritance basis emphasizes the living successors and bases progressivity upon the principle that people who receive more should pay more. Adoption of estate basis might, in the long run, have a significant effect upon Ontario testamentary practice. Since Ontario rates are now minimized where an estate is broken up among many beneficiaries, such wide distribution is common. Adoption of the estate basis would remove this incentive to wide distribution. Adoption of the inheritance basis would probably not change present Ontario practice.

The Committee considers that the rate schedule should work on the slab basis as does the personal rate schedule in the Income Tax Act. This method obviates the necessity of complex notch provisions. By the slab basis is meant tax at X% on the first dollars, at Y% on the next number of dollars and so on.

In connection with charitable gifts and gifts to the Crown or public agencies, the Committee believes that, if the estate basis be adopted, such legacies or gifts should be deducted from the net value of the estate with resultant lowering of the applicable rates.

Creditable taxes arise in the case of gifts caught by the add-back rule upon which gift tax has been paid, property subject to income tax in the terminal period of the deceased by reason of Section 70 of the Income Tax Act and foreign death taxes. The Committee suggests that these cases can be analogized and the method of calculating credit heretofore used for foreign tax credit be applied to all three.

Many persons have been in the practice of leaving legacies or trusts in precise figures to relatives and the remainder to charity. This practice has been used as a tax avoidance device but it also represents an important form of charitable giving. The Committee does not think that the government should discourage charitable remainders but a device must be adopted to eliminate the possibility of using the charitable remainder as a tax avoidance technique. Accordingly, it is proposed that where the remainder is left to a tax-exempt body but is liable to bear debts and duties on the legacies left to the non-charitable beneficiaries, the non-charitable beneficiaries should be taxed at a higher rate. The Committee proposes that in such cases the rate applicable to them should be the rate arrived at as described above plus the square of such rate plus the cube of such rate. This formula approximates the formula devised by the courts to deal with a similar problem in the old Dominion Succession Duty Act and in the Estate Tax Act but it avoids tedious calculations.

Domestic Estates

A. If the estate basis be adopted:

1. Determine the size of the gross estate value by including all of the property of the deceased according to the extended definition.
2. Determine the size of the net estate value by deducting from the gross estate debts and exempt interests which are also deductions from gross, that is gifts to charity and to the Crown.
3. Determine the gross rates by reference to the size of the net estate value. E.g., if the rates were 10% on the first \$100,000, 20% on the next \$100,000 and 30% on the balance, the gross rates on a \$250,000 net estate would be
$$\frac{10,000 + 20,000 + 15,000}{250,000} \times 100 = 18\%$$
4. If any taxable benefit is entitled to be exonerated from duty out of a fund which is exempt and a deduction from the gross estate value, increase the gross rates by applying the formula $x + x^2 + x^3$ where x is the gross rate otherwise determined. E.g., if the gross rate hitherto determined was 18%, the formula would mean that the gross rate would become
$$18\% + (18\% \times 18\%) + (18\% \times 18\% \times 18\%) = 21.82\%$$
5. Determine the value of each beneficiary's interest in the net estate value.
6. Determine the taxable interest of each beneficiary by deducting from the value of his interest any exemption to which he is entitled.
7. In the case of widows where there are also dependent children deduct, from the result obtained in step 6, the unused portion of the children's exemptions.

8. The gross tax payable by each beneficiary is determined by applying the gross rate to his taxable interest.
9. The net tax payable by each beneficiary is then calculated by deducting from the gross tax, in order:
 - (a) the lesser of gift tax paid in respect of property which has been given inter vivos and which has been included in the taxable interest of such beneficiary, and the succession duty otherwise payable in respect of such property;
 - (b) (if a tax credit system is adopted in respect of capital gains at death), the lesser of the income tax payable in respect of deemed realizations of capital property of the deceased forming part of such beneficiary's interest and the succession duty otherwise payable in respect of such property; and,
 - (c) the lesser of the death taxes payable in respect of property forming part of such beneficiary's interest situated outside Ontario to the jurisdictions in which such property is situated (according to Ontario situs rules) and the succession duty otherwise payable in respect of such property.

Capital property and foreign property shall be deemed to be the proportion of each beneficiary's taxable interest, as they are a proportion of the entire gross estate unless one or more particular beneficiaries are the particular successors to the capital property of foreign property either as successors thereto otherwise than by the terms of the deceased's will, or as specific legatees thereof under his will.

B. If the inheritance basis be adopted

1. Determine the value of the interests of each beneficiary.
2. Determine the applicable gross rate of each beneficiary having regard to the size of his interest.

For example, suppose the interest is \$100,000.

Suppose the rates, on an inheritance basis, are 10% on the

first \$50,000, 20% on the next \$50,000, and 30% on the balance. The gross rate would be $\frac{\$5,000 + 10,000}{100,000} \times 100 = 15\%$

3. If the beneficiary is entitled to be exonerated from duty, out of a fund which is exempt and a deduction from the gross estate value, increase the gross rate by applying the formula $x + x^2 + x^3$ where x is the gross rate hitherto determined.

For example, if the gross rate was 15%, the formula would mean that the gross rate would become

$$15\% + (15\% \times 15\%) + (15\% \times 15\% \times 15\%) = 17.58\%$$

4. Determine the taxable interest of each beneficiary by deducting from the value of each beneficiary's interest any applicable exemptions.
5. In the case of widows where there are also dependent children deduct, from the result obtained in step 4, the unused portion of the children's exemptions.
6. Determine the gross tax of each beneficiary by applying the gross rate to his taxable interest.
7. The net tax payable by each beneficiary is then calculated by deducting from the gross tax:
- (a) the lesser of gift tax paid in respect of property which has been given inter vivos and which has been included in the taxable interest of such beneficiary and the succession duty otherwise payable in respect of such property.
 - (b) (if a tax credit system is adopted in respect of capital gains at death), the lesser of the income tax payable in respect of deemed realizations of capital property of the deceased forming part of such beneficiary's interest and the succession duty otherwise payable in respect of such property; and,
 - (c) the lesser of the death taxes payable in respect of property forming part of such beneficiary's interest situated outside Ontario to the jurisdictions in which such property is situated (according to Ontario situs rules) and the succession duty otherwise payable in respect of such property.

Capital property and foreign property shall be deemed to be the proportion of each beneficiary's taxable interest, as they are a proportion of the entire gross estate unless one or more particular beneficiaries are the particular successors to the capital property or foreign property either as successors thereto otherwise than by the terms of the deceased's will, or as specific legatees thereof under his will.

7. Charities and other exempt gifts would be simply not taxable.

Non-Ontario estates

The beneficiaries of foreign estates should be charged at a flat rate equal to the maximum Ontario rate without exemption unless they choose to file returns as would be filed in respect of an Ontario estate, when the rate shall be set at the applicable domestic levels for such a beneficiary of such an estate.

It is proposed that duty on property having a situs in Ontario owned by a non-domiciled deceased and on accessions received by an Ontario resident from a foreign estate be payable at a high flat rate, perhaps equal to the maximum Ontario rate, except that where the successors elect to establish to the satisfaction of the Minister that on the basis of the deceased's total estate a lesser rate would be payable, the lesser rate shall be payable.

Appeal procedures

The Committee noted the considerable volume of criticism directed toward Section 33 of the present Act. The general feeling was that too great a period of time was necessarily involved in complying with the procedure before the matter became a cause in the Supreme Court.

It is presently necessary for a period of up to six months and ten days to elapse before the matter becomes a cause, and that period

may well follow a lengthy period of negotiation with Revenue officials before appealable statements under the Act are issued. This was felt to be unreasonable as frequently during this time some assets remained unreleased preventing their distribution to beneficiaries.

The Committee recommends that upon request, separate appealable notices of assessment of duty be forthwith issued to each interested beneficiary and donee with a copy to the estate executor or administrator. This would give a definite commencement point for any appeal against the assessment by the beneficiary.

The Committee has been informed by the Succession Duty Branch that the present practice of issuing a Statement of Duty to the estate executor or administrator, while not in appealable form, has not generated much criticism but is looked upon as having the advantage that time is not running against the beneficiary while he makes a decision whether to appeal.

If a beneficiary wishes to appeal, the procedure ought to be simple involving an initial objection to the assessment designed to trigger an administrative review by a different person than the original assessor or valuator, and a later appeal to the Court when the objection results in confirmation of the assessment, or when the objection produces no action within a stipulated time period.

The Lawrence Committee recommended the creation of a Companies Court, as a division of the High Court. In the Committee's view, the lawyers who are involved in the type of matters which would come before the Companies Court, are more often than not the same persons as those who would be acting on appeals under Revenue statutes. It would therefore make sense to join these matters in the jurisdiction of one Court. In this connection, companies

matters involve equity as does the interpretation of wills and trusts necessarily involved in taxing estates. Probably for the reasons above mentioned, the Chancery Division of the High Court in England embraces taxation, as well as the interpretation of inter vivos and testamentary trusts and company matters within its jurisdiction.

The Committee generally recognizes and endores the desire of the Ministry of Revenue for uniformity and standardization in appeal procedures within its revenue statutes.

X

ADMINISTRATIVE CONSIDERATIONS

The Committee makes a number of recommendations relating to procedural provisions in the statute.

The Committee is of the view that there is great value in standardizing the administrative provisions of Revenue statutes. But as outsiders with experience in dealing with governments, they took the view that they should separately express some preferences in this area.

A second general proposition to which they attach importance is the doctrine that new procedures should be avoided where existing legal categories can be made to serve. As a society we have elaborated too much law, too many procedures, rules, regulations. Law reform commissions struggle to simplify the law generally. In legislating the government can minimize the addition of complexity by using existing ancillary procedures where they can be made practically applicable.

For example, they have suggested a lien for deferred taxes on the speculative value of agricultural land. Such lien should be analogized to a mortgage and mortgage enforcement procedures should be incorporated by reference and used.

They consider that the statute should convey to the Minister some particular powers and duties as follows:

(a) Power to the Minister to investigate any matter whatsoever in connection with his administration of the statute. In other words, it ought not to be open to a resident to refuse to answer a question upon the ground that the Minister is acting ultra vires his powers to investigate the taxation of any particular estate.

(b) Power to the Minister to put questions to any resident orally, or by a written demand. He may generally or specifically

authorize in writing civil servants or others to act on his behalf in this regard. Residents so asked are bound to reply except where they may claim privilege. The benefits of The Evidence Acts should apply except as to a monetary claim by the Minister based upon evidence provided under protection of such Acts.

- (c) In connection with the obtaining of information, the Minister should be empowered to summon a person to attend to answer the questions of a named person at a named time and place. In such circumstances the witness so summoned should be entitled to all the rights of a witness in the Supreme Court including conduct-money, fees, and counsel.

The reference to The Evidence Acts, and to counsel fees is not suggested by any abuse which has taken place which would be alleviated by these safeguards. They are suggesting an Act for the long-run when it is possible that the Act may be administered by a vindictive administration concerned to wreak vengeance upon opposing political supporters, or members of economic classes which did not support its election.

- (d) The Minister should have the right to obtain upon ex parte application to a Judge of the Supreme Court and upon a showing of reasonable cause, a writ of assistance to enable him to enter upon private property, to search the same and to seize documents, except privileged documents, without limit but in all such cases he should be obliged within some short time limit, to make a return to the Court and present true or photostatic copies of the documents in question and either:

- (i) keep the copies (which the Act should elevate into the status of originals for evidentiary purposes) and return the originals, or if he can show cause why this is needed

- (ii) keep the originals and return the copies (which should also have the force of originals for the purposes of the owners, e.g. a will).

(The Judge upon such a return should have power to resolve privilege questions.)

Individuals should be prohibited from destroying or removing from Ontario any document belonging to or relating to the estate of a deceased until tax has been assessed and paid, or until the Minister has given his consent.

They suggest reference to a writ of assistance rather than to a specific statutory power again to incorporate an existing procedure, rather than to design a new one.

(e) The Minister should have resort to the Courts for the following purposes:

- (i) the collection of tax by an action;
- (ii) the appointment of a Receiver or a Receiver Manager where it is thought that assets may be upon the point of being removed from Ontario, or being destroyed either deliberately, or by neglect, and the assets are of the character to require the elaboration of receivership and/or management. This appointment should be upon notice but an interim appointment should be available ex parte upon reasonable grounds;
- (iii) the issue of Writs of Assistance, referred to above, and of Immediate Extent to seize assets in the hands of any person on account of taxes due, or potentially due, the writ being the remedy when the subject-matter is money, or securities, or chattels of value.

In connection with receivership or the issue of Writs of Extent, the Minister should be obliged to pursue the assessment procedure promptly within precise time limits, and to return excess property promptly. But he should be able to sell the property seized by writ, and the Receiver should have a like power of sale. It is suggested that the sale in either event should be court-approved and supervised.

- (f) The solicitor and client privilege should always be applicable to questions asked or documents seized with a code of procedure to determine a claim of privilege after the manner of but improving upon the code enacted into the Income Tax Act in 1965. The excessive zeal of the Special Investigation Branch of the Department of National Revenue has exposed weaknesses in the code unfairly jeopardizing the taxpayer or his lawyer.

The traditional writings, and decided cases dealing with civil liberties have emphasized protection for the individual against the political arm of the state. But in contemporary society, the individual needs protection against the bureaucracy who will not torture or imprison him, but may well embroil him in procedures, and put him to unnecessary costs of compliance. It is for this fundamental reason that we suggest costs as well as privilege.

Offences and Penalties

- (a) Time limits for compliance should be reasonable to the point of generosity.

At present time limits are too short and are widely ignored. This

means that the Minister is being constantly forced to be responsible for the use of discretionary relief provisions. We think this is an unfair burden upon the Minister.

- (b) Consistent with point (a), breach of time limits with respect to filing documents or answering questions should involve
 - (i) penalties which should be fairly automatically invoked where there is total non-compliance (as opposed to the rendering of inadequate replies), and
 - (ii) completely automatic penalties in the same circumstance.
- (c) Breach of time limits with respect to payments should simply involve interest.
- (d) Deliberate destruction of documents, intentional falsehood in returns or answers, procuring, aiding or counselling either should involve an indictable offence or an offence punishable upon summary conviction.
- (e) Grossly negligent inaccuracy in returns or answers where the person replying took no reasonable precautions to ensure accuracy should involve an offence punishable upon summary conviction, or a civil penalty to be imposed by the Minister similar to that in the Income Tax Act.

Secrecy

The statute should expressly negate the use of the returns and information gathered by the department for any purpose whatsoever save

- (a) assessment and collection of taxes due,
- (b) statistical purposes not involving publication, even to other departments, of details which would identify the case.

The sanctions should be two-fold:

- (a) We suggest that Ontario enact an Official Secrets Act with its own code of procedures and penalties. It would have its uses for all civil servants, as well as advisory committees and ad hoc consultants

and advisers. But it could properly cover the point at issue here.

A right of action for any individual harmed by the disclosure even though the disclosure be true. For example, suppose in an estate the testator should have set up a secret inter vivos trust, only disclosing same to the tax authorities, making provision for his son and his son's mistress, a lady whose identity or existence is unknown to the son's wife. Suppose the information be improperly disclosed and the son be sued for divorce. There may be ultimate justice in the result but individuals are entitled to consider that their tax returns are confidential and that the tax content in them, however unsavoury, is a secret confined to the state and the individual.

Regulations, Schedules, and Policy Statements

- (a) The power of legislation by regulation has been viewed with suspicion by judges, lawyers and political scientists. And yet it is so obviously a necessity of modern government. The lawyers on the Committee will concur in the plea that the scope of regulations be as precisely defined as possible so that a future government may not, by statutory order, effectively amend, qualify or frustrate the clearly expressed words of the legislature.
- (b) Matters of permanent detail such as rates or exemptions structure could be excluded from the body of the statute but should be in a schedule forming part of the enactment and not be found in a regulation.
- (c) It is suggested that the regulations should be expected to deal with three subjects:

- (i) forms
 - (ii) authority of persons to act for the Minister
 - (iii) administrative procedures below the level of the vital matters affecting rights which should be underlined by appearance in the statute.
- (d) It would be hoped that a new bill could be accompanied, at the time of its printing by a draft of the regulations.
- (e) The Department as a whole should publish its policy statements as to all its policies in assessment. In effect, the Department should tell the taxpayers "This is how we interpret the Act; if you wish, try to persuade us we are wrong - if you fail, we will see you in Court".

The argument for such publication is certainty. The principles of valuation as understood and applied by the Succession Duty Branch are an example. These principles are not easily discovered by say, a young solicitor or trust officer. In the result, valuation becomes a mystery, carefully preserved as such by its initiates. In our opinion, no administrative branch of government should rely on a "rule of thumb", or a "policy", or a "pattern", or even a "custom" in carrying out responsibilities unless it is prepared to publish a description of the rule or pattern so that those who deal with the branch infrequently should be on more equal terms with the specialists.

There is a class of humanity always trying to unravel complex things in terms of a conspiracy, or fraud. Politicians, and to a lesser extent civil servants, suffer from this tendency. It is therefore in their interest to remove the mystery from administration where possible. The publication of the actual policies pursued by the Department is of major assistance in this regard.

Publication can be to subscribers only and subscribers will pay the cost, if that cost is for the provision of fast, accurate information (rather than for elegant type on glossy paper with illustrations). We would visualize a weekly (when there is anything to say) of no standard size but including:

- (a) the text of amendments to bills introduced into the Legislature.
- (b) a note as to the progress of bills and the proclamation date of the statutes which result.
- (c) the text of new regulations and information about effective dates.
- (d) new policy statements or amended policies.
- (e) changes in officers or addresses or telephone numbers of offices.
- (f) reports of decided cases (whether or not to be published in any law report).
- (g) rulings given.

Subscribers might also get a pamphlet copy of consolidated bills, and associated regulations when these become available, and a periodic index.

It might be that this service would be better provided by a commercial legal publisher. In any event, it would be preferable if it were an individual publication for each statute appearing as needed.

XI

THE STRUCTURE AND LANGUAGE OF THE STATUTE

The language of the new statute should be simplified.

The Committee requires that the Succession Duty Act when renamed (as it should be to bury effectively that which will disappear in the new version) and rewritten should

(a) be as simple and clear as the present statute is complex and confusing,

(b) be a sample and a sign-post to the Parliament and the other legislatures as clearly-written, a taxing statute as Income Tax Act is obtusely structured, and unclear.

Suggestions of the type of simplicity to use would include the statement of formulae in algebra rather than in words, the use of declaratory statements of intent, somewhat after the manner of U.S. legislation, and schedules illustrating the calculation of the amounts where necessary.

It is hoped that when a bill is introduced it would be printed with long marginal notes so as to become a text for practitioners, and be accompanied by a draft of the regulations.

Retroactivity

Insofar as the new statute brings into tax inter vivos transactions exempt under present law, a date in the statute should prevent a retrospective effect being given to the new charging provisions.

In dealing with property law, certainty must be as great an objective as simplicity. It would appear that in order to deal with loopholes fairly, radical revisions must be made to the scheme of the Ontario law bringing into tax transactions hitherto free from tax.

In making a fundamental law reform it is better to give the practitioners a chance to assimilate the new law. Otherwise an unfair advantage is given to big firms and the clients who can afford to retain them.

If a lawyer is asked by a client today with respect to the taxability of a gift made to that client by a foreigner, the lawyer is able to answer based upon existing law that the gift will not be brought into tax regardless of when the foreign donor dies unless the property has a situs in Ontario or unless the gift is made here. That position is clear and certain. We have recommended an accessions tax. It logically follows from an accessions tax that inter vivos dispositions within three years from death (the period we have recommended) by the foreign deceased are also taxed as accessions. Hence the transaction today which the Ontario lawyer opines is tax free, becomes retroactively taxable unless specifically excluded.

For example, Section 9 of The Succession Duty Act of Saskatchewan is the charging section and 9(2) brings into charge accessions. The successor is taxed. Section 2(gg) of the Saskatchewan Act defines successor and includes a person who at any time before or on or after the death of the deceased became or becomes beneficially entitled to any property of the deceased, inter alia, "under any disposition made by the deceased during his lifetime". Disposition has its ordinary meaning. Imagine for example, a gift made today in the State of New York by an American resident consisting of property situate in the State of New York, in favour of a Canadian donee while not taxed under the existing law of Ontario, the gift would be brought into tax if the donor today, died in the next three years and if Ontario enacted the Saskatchewan provisions, without any section dealing with the date of application for this purpose.

Terence Sheard's original text on wills is a common drafting tool today despite the passage of the Estate Tax Amendments in 1968 and the new income tax bill in 1971 (and the publication of newer texts, including a new edition of the Sheard text). The rate at which lawyers assimilate new tax laws is slower than it might be.

But their clients are far slower still to change their wills in the light of new law. Persons will die throughout the remainder of this century with wills drawn in light of the provisions of the Estate Tax Act despite the irrelevance of that Act to any death after 1971.

The government need not defer to these tendencies indefinitely. But it should not copy the complete insensitivity to them of the federal government in its handling of fundamental tax changes.

Noting the date contained in Section 1(r)(xi) of the present Succession Duty Act, we have a precedent in dealing with dispositions. Accordingly, we suggest that an inter vivos transaction which is not taxable under the existing Succession Duty Act, should not become taxable under the new Act which replaces it unless it takes place after the new Act has come into force.

APPENDICES

MINISTERIAL ORDER APPOINTING THE COMMITTEE

Advisory Committee on Succession Duties

I am pleased to announce the establishment of a special Advisory Committee to undertake a thorough examination of the existing Succession Duty Act.

The Committee will be known as the Advisory Committee on Succession Duties. Its membership will be comprised of the following:

J. Alex Langford, Q.C., Chairman
Elmer D. Bell, Q.C.
J. Albert Brule, Q.C.
Wolfe D. Goodman, Q.C.
John Hodgson, Q.C.
R. Bredin Stapells, Q.C.
Frederick S. Mallett, C.A.
Garfield P. Smith, F.C.A.
Henry N.R. Jackman, Insurance Company Executive
Reginald L. Kayler, Q.C., L.L.B., C.L.U.
S. Sheldon Taerk, C.L.U.
Terence M. Russell, PH.D.
Derek W. Rowsell
D. Lyall MacLachlan, B.Sc.
A. John Cheney, C.A.
Isaac Stephenson, C.G.A., Executive Director

G. Melvin Bird became member on August 15th, 1972

The terms of reference are:

- (A) Make a comprehensive review and thorough examination of the presently existing Succession Duty Act;
- (B) Enquire into and report to the Minister of Revenue upon the implication of the impact of succession duties on the family farm, family business and on Canadian versus foreign control of business;
- (C) Enquire into and report to the Minister of Revenue upon the relationship between succession duties and the present exemptions relevant to charitable, cultural, educational and religious organizations;
- (D) Consider and report to the Minister of Revenue a better means of raising from the death and gift tax fields an amount of revenue equal to the yield from current legislation;
- (E) Advise the Minister of Revenue on a revision of the present Succession Duty Act;
- (F) Examine and report to the Minister of Revenue upon the relationship between the administration of The Succession Duty Act and The Surrogate Courts Act with the objective of avoiding duplication of costs in the administration of related statutes;
- (G) Enquire into and report to the Minister of Revenue upon the implication of the impact of succession duties and gift taxes on the concentration of wealth in Ontario and the investment in Ontario resources.
- (H) Enquire into the effect on the maintenance of a healthy climate for continued growth in Ontario, by reason of the nature of intention of other provinces, to withdraw or remain out of The Succession Duty and Gift Tax fields.

ALLAN GROSSMAN
Minister of Revenue

Dated at Toronto
This 6th day of
June, 1972

COMPUTER MODEL

Reference is made in Chapter III of the Report to a computer model developed by Departmental staff at the request of the Committee. The model was prepared on the basis of an initial survey of 300 taxable estates and refined by reference to a further 400 estates.

It is the opinion of the statisticians that the model produces results accurate to within a range of $\pm 7\%$ for estates at moderate levels. However, the model tends to understate by a wider margin the yield from larger estates. For example, it has happened that a single estate produced over 10% of the total provincial succession duty revenue in a given year. Such events obviously distort projections based upon average experience.

RATES AND YIELDS

The computer model was used to produce tax yields under two possible cases:

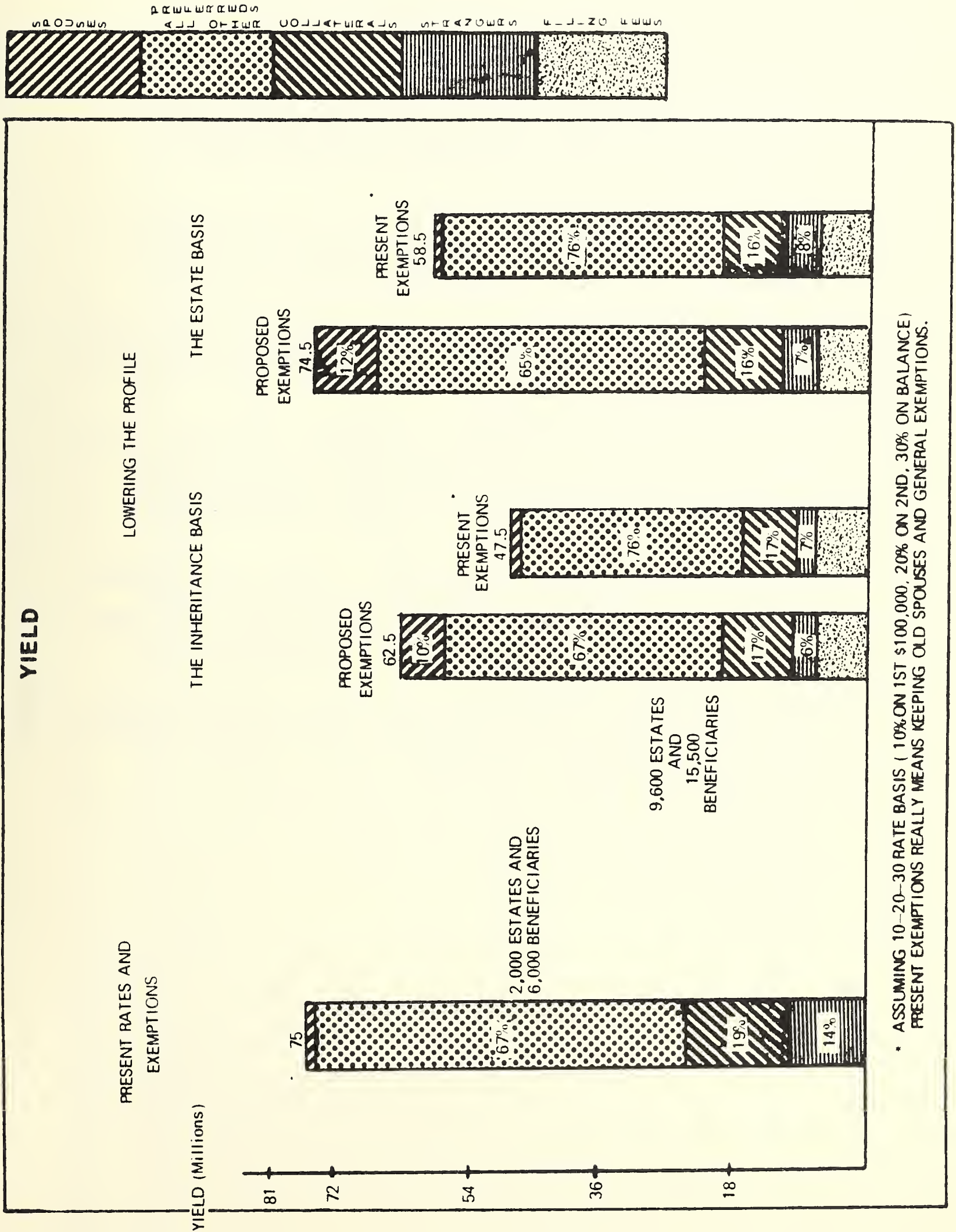
1. One case assumed that rates were based on the net size of the deceased's estate. It assumed rates of 10% on the first \$100,000, 20% on the second \$100,000 and 30% on the balance. Such rates would of course only apply to the taxable portion of any given beneficiary's interest.
2. The other case assumed that rates were based on the size of each beneficiary's benefit, without regard to the size of the estate. It assumed rates of 10% on the first \$100,000 worth of net value, 20% on the second \$100,000 and 30% on the balance, before deducting the beneficiary's exemption.

In both cases we worked out two alternatives -

- (i) assuming that the two revenue - significant exemptions were altered in accordance with Committee recommendations.
- (ii) assuming that the two revenue - significant exemptions were not changed.

We assumed that all other exemptions would be changed in accordance with our recommendations.

THE RATE DILEMMA



Examples of the Rate Schedule

Notes

1. The Estate basis - In these calculations, rates, based upon the size of the estate after deducting debts, are applied to the portion of each individual beneficiary's benefit left after deducting the deductions.

2. The Inheritance basis - In these calculations the rates are based upon the size of each beneficiary's benefit. The rates so arrived at are then applied to the taxable portion of each beneficiary's benefit.

This is the usual Ontario technique of dealing with exemptions. Its effect is to make a given exemption of equal value to any beneficiary, regardless of the size of his benefit.

(The opposite technique, employed in the Income Tax Act, is to deduct the deductions first, and base the rates upon the taxable portion only. This technique means that a given deduction is more valuable to the beneficiary with the larger benefit.)

3. Estate vs. Inheritance bases - It will be apparent from the foregoing bar graph and from the following tables, that a given set of rates yield less using the inheritance basis. Accordingly, the desired revenue yield is obtained by adjusting the rates upward.

4. It should be remembered that in our recommendations we have suggested that all duties can be paid in monthly, quarterly, or annual instalments with interest, on a fully amortized ten year plan.

WIDOWS

Assume an estate left entirely to a widow. Since there is only one beneficiary, the estate and inheritance bases produce the same tax.

Our proposal is to express the widow's exemption in terms of an annual amount of income. This makes the exemption vary with the age of the widow, the exemption being larger for a younger widow. In the following table, the widow's tax is calculated upon the basis of \$15,000 per annum being the figure chosen. A higher figure would produce less revenue.

<u>Age of Widow</u>	<u>Size of Estate</u>	<u>Present Tax</u>	<u>Proposed Tax</u>
50	150,000	0	0
	250,000	0	6,593
	500,000	0	68,790
	1,000,000	235,000	212,389
60	150,000	0	0
	250,000	0	13,380
	500,000	0	77,840
	1,000,000	235,000	222,570
70	150,000	0	2,858
	250,000	0	21,858
	500,000	0	89,144
	1,000,000	235,000	235,287
80	150,000	0	9,532
	250,000	0	30,868
	500,000	0	101,157
	1,000,000	235,000	248,802

ADULT (NON-DEPENDANT) CHILDREN

Assume an estate divided equally between two adult, non-dependant children.

<u>Size of Estate</u>	<u>Taxes</u>			
	<u>Each Child</u>		<u>Total Tax</u>	
	<u>At Present</u>	<u>Estate basis</u> <u>Inheritance basis</u>	<u>At Present</u> <u>Estate basis</u> <u>Inheritance basis</u>	<u>Estate basis</u> <u>Inheritance basis</u>
150,000	8,250	8,660 6,500	16,500 17,320	13,000
250,000	22,500	20,700 13,800	45,000 41,400	27,600
500,000	54,150	57,600 43,200	108,300 115,200	86,400
1,000,000	150,000	132,300 117,600	300,000 264,600	235,200

NON-RELATIONS
(friends, mistresses, etc.)

Estate left to two non-relatives equally. Neither is a dependant.

<u>Size of Estate</u>	<u>Each Beneficiary</u> taxes		<u>Now</u>	<u>Inheritance</u>		<u>In All</u> <u>Estate</u>	<u>Inheritance</u>
	<u>Estate</u>						
150,000		12,500	8,700	6,500	25,000	17,400	13,000
250,000		37,500	20,700	13,800	75,000	41,400	27,600
500,000		100,000	57,600	43,200	200,000	115,200	86,400
1,000,000		225,000	132,300	114,600	450,000	264,600	229,200

Note:

Present Ontario rates vary depending upon the degree of relationship. "Preferred beneficiaries" are ancestors, descendants and one's immediate family. "Collateral beneficiaries" are other relatives. The remainder are anathematized under the heading "strangers".

The Committee sees no logical principle acceptable in current social terms for these distinctions. To begin with, the differentials express a puritanical preference for some classes of beneficiaries. Where such preferences are proper concerns of government, they appear in dependants' relief laws. Apart from such direct interference, the government should not tell a man through a rate structure to whom he should leave his property.

Further, the present differentials may represent an old attempt to categorize closeness of actual relationship. Such assumptions are out of place today. People may be much closer to "strangers", or to "collaterals" than to some "preferred beneficiaries".

Finally, no one leaves property to strangers. People leave property to friends, or lovers. Seen in these terms, the primitive "stranger" rates are bizarre.

We firmly recommend a single rate schedule.

COLLATERALS

Estate left to two grandnephews equally.

<u>Size of Estate</u>	<u>Taxes</u>		<u>Inheritance</u>	<u>Now</u>	<u>In All Estate</u>	<u>Inheritance</u>
	<u>Each Beneficiary Estate</u>	<u>Now</u>				
150,000	8,700	12,500	6,500	25,000	17,400	13,000
250,000	20,700	37,500	13,800	75,000	41,400	27,600
500,000	57,600	93,750	43,200	187,500	115,200	86,400
1,000,000	132,300	225,000	114,600	450,000	264,600	229,200

See note to Table 4.

Our proposed schedule here is exactly the same as that in Table 4.

DEPENDANT ADULT
(not a child of the deceased)

Estate left to fully-dependant, unrelated adult.

<u>Age of Beneficiary</u>	<u>Size of Estate</u>	<u>Tax Now</u>	<u>Proposed Tax</u>
40	150,000	25,000	3,851
	250,000	75,000	23,198
	500,000	200,000	89,000
	1,000,000	450,000	237,300
60	150,000	25,000	8,400
	250,000	75,000	29,200
	500,000	200,000	99,000
	1,000,000	450,000	246,300
80	150,000	25,000	14,765
	250,000	75,000	37,900
	500,000	200,000	110,600
	1,000,000	450,000	260,000

WIDOWS AND DEPENDANT CHILDREN

Assume an estate left to a widow for life, with remainder divisible equally between 2 children, age 2 and 7.

<u>Age of Widow</u>	<u>Size of Estate</u>	<u>Tax on Widows</u>		<u>Tax on Younger Child</u>		<u>Tax on Elder Child</u>		<u>Total Tax</u>	
		<u>Now</u>	<u>Estate</u>	<u>Inheritance</u>	<u>Now</u>	<u>Estate</u>	<u>Inheritance</u>	<u>Estate</u>	<u>Inheritance</u>
25	150,000	0	0	0	0	0	0	0	0
	250,000	0	0	0	0	0	0	0	0
	500,000	0	43,152	41,646	0	0	0	43,152	41,640
30	150,000	0	0	0	0	0	0	0	0
	250,000	0	0	0	0	0	0	0	0
	500,000	0	42,000	40,400	0	0	0	42,000	40,400
35	150,000	0	0	0	0	0	0	0	0
	250,000	0	0	0	0	0	0	0	0
	500,000	0	40,500	38,640	0	222	92.50	40,722	38,722

ORPHANS

Assume estate left to orphans age 1, 3

<u>Size of Estate</u>	<u>Tax on Elder Child</u>		<u>Tax on Younger Child</u>		<u>Total Estate</u>	
	<u>Now</u>	<u>Inheritance</u>	<u>Now</u>	<u>Inheritance</u>	<u>Now</u>	<u>Inheritance</u>
150,000	5,750	0	5,750	0	11,500	0
250,000	20,000	0	20,000	0	40,000	0
500,000	51,650	20,780	51,650	21,500	103,300	42,300

A STUDY INTO LIQUIDITY PROBLEMS
CREATED BY THE IMPACT OF SUCCESSION DUTY

As the Committee was directed to enquire into and report upon the implication of the impact of succession duties on the family farm, family business and on Canadian versus foreign control of the business, a comprehensive study was made of the actual administration of the estates of persons who had died in the years 1970 and 1971.

In these particular years, the level of exemptions under the Succession Duty Act were much lower than they are today and, therefore, succession duty was payable in a greater number of estates than if the decedent had died on or after January 1st, 1972.

A questionnaire was prepared and mailed to the representatives of the estates where, from the information available from the succession duty records, the decedent had assets consisting of:

- a) Real property and from the legal description thereof could be assumed to have been used for agricultueal purposes, and
- b) The controlling interest in equity shares of a closely held family business.

Family Farm Questionnaire

The following questions were asked of the estate representatives:

- 1) Was the title to the real estate transferred to the beneficiary(ies) (or held in trust for them?)
- 2) If the real estate was sold
 - (a) Was it sold primarily to raise monies to pay liabilities payable at death (including succession duties and/or estate tax?)
 - (b) If the real estate was sold to meet liabilities payable at death, were succession duties and/or estate taxes a significant portion of the total?

- (c) Was it sold primarily to facilitate the distribution of the estate amongst the beneficiaries?
- (d) Was it sold primarily as there was no one in the family to effectively carry on the farming operation?
- (e) Was the purchaser a bona fide farmer who intended to use the lands for agricultural purposes?
- (f) Did the sale result in the property passing to foreign ownership?

Comments

(We would encourage you to expand on your answers to any of the foregoing questions, and to provide us with your views upon any related matter).

There was an excellent response with the following results:

Number of questionnaires mailed	- 277
Number of questionnaires returned	- 217
No reply	- 60
Percentage responding	- 78%

In 161 estates out of the 217 responses, the farm was not sold. The title of the real estate was transferred to the beneficiary(s) or held in trust for them.

The farms sold in the remaining 56 estates reporting, were sold for the following reasons:

- (a) Primarily to raise monies to pay liabilities payable at death (including succession duties and/or estate tax) - - 10 cases
- (b) Primarily to facilitate the distribution of the estate to the beneficiaries - 30 cases
- (c) Primarily as there was no one in the family to effectively carry on the farming operations - 16 cases
- Total 56 cases

Although the question was not answered in all instances where a sale had taken place, in 28 of the cases the purchaser was a bona fide farmer who intended to use the lands for agricultural purposes.

In no case did the sale result in the family farm passing to foreign ownership.

In addition to the questions, the correspondents were encouraged to expand on their answers to any of the questions and to provide us with their views upon any related matter.

A number did respond but many remained silent. The greater percentage of those responding indicated that succession duties created no financial hardship, as the deceased had other financial resources. On the other hand nine respondents were critical of the burden of succession duties and/or estate tax placed upon the survivors.

Typical comments

"While it was not necessary for the widow to sell the farm in order to enable her to pay the succession duty and estate tax, nevertheless the duty and tax which she did pay did result in some hardship for her, particularly since she had dependent son who was still attending school. This woman is presently working in the tobacco industry in order to supplement her income."

"The deceased devised the lands in question to his daughter, who had been residing upon and operating the farm for many years under a lease with her father. The deceased was possessed of sufficient cash resources to pay all succession duties. There is nothing I can suggest in connection with this estate that would be of assistance to the Committee."

"The beneficiary had to borrow money to pay taxes in this estate."

"The deceased had, prior to his death, entered into a binding offer to purchase and sell with A.R.D.A."

"The property is up for sale and the chief reason is that there is no near family to effectively carry on the farming operation."

"Lands were sold to a nephew of the deceased who had helped the deceased in his farming operations during his lifetime."

"The lady ... died with little assets other than the farm property. We immediately tried to sell the farm to raise funds for succession duties and debts but were unsuccessful in disposing of the property. At that time it was a very grave hardship for the widow as she had very little means. In order to satisfy all financial obligations, she cashed an insurance policy and borrowed money from the bank. Recently the property has been sold and it will be closing shortly and this will enable the widow to obtain the funds to pay back the bank loan and other obligations. The matter caused the widow grave hardship and the only son endeavoured to assist in the carrying on of the farm operation."

"The deceased left widow and four daughters but no son - proceeds from the sale of the farm were invested to provide income for widow - farm was sold to a neighbour whose father owned the farm across the road - estate took back mortgage as part of the purchase price."

"Parts of the real estate were transferred to some of the beneficiaries of the estate and other portions were sold to relatives of one of the beneficiaries as part payment of her share of the estate."

"Sufficient cash in estate to meet all duties."

"Fortunately, the decedent had some readily realizable investments which were sold to pay duty and allow retention of the farm for the son who had farmed this property with his father."

"I believe that the impact of succession duties in this area is less damaging to the family farm than the gift tax legislation which coupled with the very high prices of farm land, machinery and livestock, has made it virtually impossible for a farmer to sell to his son at a price that would enable the son to make a decent living and get his initial debt paid before he is an old man."

"The problem still remains, however, that where a family holds together a large block of land which is not particularly productive, and the land is then valued in accordance with comparable sales where developers have inflated the prices, the farming operation is then put in jeopardy."

"The deceased had sufficient funds on hand to pay succession duties and estate tax so that his farm was divided between his two sons who are both farms subject to the life estate of their mother."

Family Business Questionnaire

The following questions were asked of the estate representatives:

- 1) Were the shares distributed in specie to the beneficiaries (or held in trust for them)?
- 2) If the shares were sold
 - (a) Were they sold primarily to raise monies to pay liabilities payable at death (including succession duties and/or estate tax)?
 - (b) If they were sold to meet liabilities payable at death, were succession duties and/or estate taxes a significant portion of the total?
 - (c) Were they sold primarily to facilitate the distribution of the estate to the beneficiaries?

- (d) Were they sold primarily as there was no one in the family to effectively carry on the business?
- (e) Did the sale result in control passing to foreign ownership?
- (f) Did the loss of the deceased adversely effect the price obtained on sale?

Comments

(We would encourage you to expand on your answers to any of the foregoing questions, and to provide us with your views upon any related matter).

There was a good response with the following results:

Number of questionnaires mailed	- 294
Number of questionnaires returned	- 197
No reply	- 97
Percentage responding	- 67%

In 157 estates, out of the 197 reporting, the shares of the family business were not sold but were transferred to the beneficiary(s) or held in trust for them.

The shares in the family business in the remaining 40 estates reporting were sold for the following reasons:

- a) Primarily to raise money to pay liabilities payable at death - 12 cases
(including succession duties and/or estate tax)
- b) Primarily to facilitate the distribution of the estate
to the beneficiaries - 22 cases
- c) Primarily as there was no one in the family to effectively
carry on the business - 6 cases
- Total 40 cases

In no case did the sale result in the control passing to foreign ownership.

Although many correspondents remained silent, the comments received were both constructive and interesting. The following are typical:

"The shares were distributed in specie to the immediate members of the family in accordance with the directions under the Will. The company is being effectively managed by the family."

"The deceased built up a substantial reserve to pay succession duty and estate tax and the beneficiaries, therefore, had no difficulty and were able to take over and continue the operation of the company without serious interruption."

"The shares of this company were sold to his son by the deceased approximately two years prior to his death. Care was taken in determining the share value of the transaction to ensure that it could be considered as an arms length arrangement. The consideration for the shares was a demand promissory note bearing interest at 6% per annum. At the time of Mr. 's death demand had not been made. Because of the nature of the transaction, it is not considered to have had any significant effect upon the amount of Ontario succession duty imposed."

"Shares unsold at present time but in all probability will have to be sold because of inability to arrange suitable management or economic terms. Loss of deceased will adversely affect sale."

"Although the shares in question have not yet been distributed to the beneficiaries, they probably will be. In any event their disposition has created no problem in this estate as far as succession duties are concerned because the estate has other assets which are more than sufficient to pay the duty."

"Shares were not sold - sufficient life insurance available to meet financial obligations and shares pass to widow as sole beneficiary."

"The operation is being wound up as no members of the family are anxious to continue it."

"The deceased in this estate was in fact the son of the president and principal shareholder of the corporation. The implication of succession duties levied in this estate did not have a significant effect on the continued family ownership of the subject corporation. The potential impact of succession duties and other forms of death taxes remains a substantial consideration in determining whether or not the disposal of the family business would suggest that any form of death tax, whether levied by way of succession duties or the de-realization of capital property at death, should be permitted to be paid over a period of at least ten years at a rate of interest not greater than the prime rate charged by Canadian chartered banks.."

"It is necessary for the estate in order to retain the shares held by the deceased in both companies to borrow the amount required to pay both the Ontario succession duty and estate tax. The money was borrowed in an endeavour to retain both companies rather than liquidating them for the purposes of paying duty."

"It is my observation that very few businesses have to be sold for succession duty purposes. On many occasions the reasons may be stated for succession duty purposes, but usually it is because no one in the family is either capable or interested in carrying on the business. Quite frequently some of the members of the family are not either prepared to work hard enough to raise the capital to pay off other members of the family. Succession duties usually do not cause this problem, but it is merely a matter of method of splitting the estate."

"The business has been run by the sons since the father's death, but it is not being run successfully and we anticipate from the last financial statement that the same will possibly be eventually liquidated or sold unless business conditions improve greatly."

"Ontario succession duties in this estate were estimated at \$23,000.00 and federal estate tax at \$95,000.00. Fortunately the deceased carried substantial insurance on his life which will enable the estate to meet this liability. Thus the business has not had to be sold or mortgaged. The business will continue to be carried on by the deceased's wife with the assistance of senior employees."

"In our opinion, due entirely to the special circumstances and to the blood relationship existing between some of the shareholders, the estate received a somewhat higher price than we think could be justified. Succession duties certainly had no impact on the whole transactions."

"In order to pay succession duties and debts of the estate the company elected under Section 105 of the Income Tax Act to pay the tax and issued 212 preference shares of par value of \$100.00 each, which were later redeemed and out of redemption price the succession duties and debts of the estate were settled."

"Shares were subject matter of a buy-sell agreement which the deceased entered into during his lifetime. The agreement was funded by insurance which provided the funds necessary to complete the transfer."

"The shares of were transferred to the beneficiaires and did not cause any adverse effect on the succession duty impact."

"At the time of his death, a buy-sell agreement was in effect with The agreement was partially funded by life insurance."

"The estate had difficulty in raising the funds to pay succession duties but due to the fact that this is a family group participating in a number of companies, they were able to raise the funds by loans from the other companies with the consent of other shareholders, otherwise it would have been a very difficult situation for the estate."

"The succession duty act should be repealed. The capital gains tax is enough."

A great deal has been said, from time to time, by many persons or groups, upon the financial impact of succession duties on the family farm and family business, and concluding that ownership or control passes to foreign ownership in a number of instances.

The source of material for our study was unique as it was taken from the records of the Succession Duty Branch and involved every estate originating in a two year period, when the level of exemptions were lower than they are today.

It is clearly shown that 78% of family owned farms are not sold but pass on to the beneficiaries of the deceased. In the 56 estates where the family farm was sold, 46 of the farms were sold for reasons other than to pay liabilities payable at death, (including succession duties and/or estate tax).

Similarly in 67% of the cases the decedent's interest in the family controlled business was passed on to the beneficiaries and not sold. In the 40 cases reporting that the business interest had been sold, 28 of those cases, the sale took place for reasons other than to raise monies to pay liabilities payable at death (including succession duties and/or estate tax).

It is significant to note that there were no cases, whatsoever, reported where a family farm or a family business was sold and control passed to foreign ownership.

THE TAXATION OF WEALTH

There are few areas of tax policy in which opinions differ more widely than in relation to the taxation of inherited wealth. On the one extreme are those who believe that inherited wealth encourages idleness and profligacy among those who inherit and that it is also a social evil which accentuates and reinforces the inequality of distribution of wealth in the community. At the other extreme are those who consider that the ability of individuals to pass their wealth to their descendants is an important incentive to the economic development of the country and that the formation and retention of major pools of capital for investment purposes requires the elimination of death taxes. This group tends to stress the serious consequences of death taxation in forcing the liquidation of family businesses and farms, leading to the concentration of business in the hands of a few, increasing foreign domination of domestic industry and encouraging wealthy individuals to leave their homes to seek financial refuge in tax-haven jurisdictions.

There seems to be merit in all of these views particularly within the context of the present circumstances facing the Province of Ontario but there are a number of factors which ought to discourage extreme views concerning the taxation of inherited wealth.

First, in a federal system, one should be wary of the view that "the State" has in good part made possible the private accumulation and maintenance of wealth and should properly share on behalf of all citizens in the prosperity of its more affluent members. Whatever the merits of this theory in a unitary state, concerning which there can be considerable room for argument, it has little place in a federal state such as ours, in which government exists on many levels, municipal, regional and federal as well as provincial.

Second, one should also be skeptical concerning the possibilities of redistributing wealth through the tax system. Canada, the United Kingdom and the United States of America have all had relatively onerous and highly progressive systems of death taxation as well as income taxation for many years, but it is very doubtful that the tax system has imposed any significant alteration in the patterns of distribution of either wealth or income in these countries. There appear to be mechanisms built into the economy which tend to pass on the effects of such taxation to the general public.

Third, even when they are in extreme disagreement on many issues of tax policy, most Canadians subscribe to the concept of taxation in accordance with the taxpayer's ability to pay. While a progressive income tax system is based upon this concept, it fails to distinguish between a given amount of income from wages, salary or the conduct of an active business or profession, on the one hand, and the same amount of income from passive investment sources, on the other. In fact, the existence of capital cost allowances and similar deductions from certain types of income and the

lower effective rate of income tax on capital gains may even have the effect of imposing a smaller burden of income tax on some forms of passive income. The possession of wealth which enables an individual to receive an income throughout his life, in sickness and in health ought to be regarded as indicating a greater capacity to pay taxes. To the extent that the income tax ignores capacity to pay, as represented by ownership of capital assets, the whole revenue system departs from the principle of ability to pay. Taxes based on wealth can mitigate this deficiency and increase the general equity of the tax system. At this point a disagreement arises between those who claim that the capital gains tax represents just such a tax on wealth, and those who say that a capital gains tax is essentially a tax on real income.

Fourth, tax laws are far from perfect and inequities are bound to arise. The Ontario Committee on Taxation refers to this problem in Volume I of its Report at paragraph 55, where it discusses the importance of "balance" in a tax system, in the following terms:

"This principle is to be found in certain textbooks under such names as "multiplicity" or "plurality", but we have chosen the term "balance" in order to emphasize the kind of plurality that a tax system should possess. The need for a balanced plurality of taxes is grounded partly in the requirements of flexibility and elasticity, partly in equity, and partly in administrative considerations. As to flexibility and elasticity, it is readily apparent that some taxes are more flexible, others more elastic. Thus the property tax is relatively unresponsive to economic change but highly flexible, whereas consumption taxes are rather more elastic but relatively inflexible. A tax system should therefore have a sufficient multiplicity of taxes to take account of these characteristics. In the domain of equity, if a tax system is to conform to the basic rule of equal treatment of equals, it must not only be able to take differing individual situations into account but also be virtually foolproof in terms of evasion."

Fifth, although the amount of wealth in private hands may be very large, the amount which passes on death in any year is only a small percentage of this figure.

A wealth tax at death

The arguments in favour of imposing a wealth tax do not necessarily justify the imposition of such taxes at death rather than at some other time. Nevertheless, there are advantages in imposing wealth taxes at death.

First, an accounting of the assets of a deceased person has to be made in any event, in order to permit the orderly administration of the estate and the distribution of assets among the beneficiaries.

Second, to a certain extent, an inheritance may be regarded as a windfall conferred on a beneficiary who may have done little to earn the inheritance and therefore should have less cause to complain about taxation than a person who is required to pay taxes on wealth during lifetime. Obviously, this argument is not always applicable. A widow will feel that during her married life she made a major contribution towards her husband's financial success. Less often perhaps, the deceased's children might also be entitled to this view. However, if the special role of the widow is recognized through an exemption mechanism, the "windfall" argument still remains valid.

Third, the fact that death taxes have traditionally been imposed in Ontario and many other jurisdictions is itself an advantage as compared with other forms of wealth taxation. There is merit in the view that an old tax is a good tax; the familiarity of taxpayers with such a tax and the ways in which the society has responded to it over many years are a strong argument in favour of retaining succession duties unless the need for change becomes almost overwhelming.

Undue concentrations of wealth

In the past, it has always been generally accepted that succession duties serve a social purpose by breaking up "undue concentrations" of wealth. If there are any undue concentrations of wealth in this province, we think they are not in the hands of individual businessmen or farmers, but in the hands of non-resident corporations or in the large institutionalized pools of capital. Succession duties and capital gains taxes, therefore, do not destroy undue concentrations of wealth; they simply aggravate the problem by facilitating the transfer of wealth into the hands of entities which may be perpetually exempt from this form of tax.

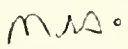
An annual wealth tax

Nevertheless little attention has been given to the possibilities inherent in an annual wealth tax. The chief difficulty in imposing such a tax is that it requires an annual listing and valuation of the net wealth of every taxpayer. The Ontario Committee on Taxation refers to "the enormity of this task". However, it should be borne in mind that the difficulties of valuation which arise in connection with the imposition of an annual wealth tax are likely to be much less serious than those which arise today in connection with the imposition of succession duties. If the rate of tax is kept low, and it has been suggested that a 1/3 of 1% rate would yield at least present succession duty revenues, only an extreme difference of opinion over valuation is likely to encourage a taxpayer to contest his assessment for an annual wealth tax.

There might be an additional advantage in the imposition of an annual wealth tax. It would assist in rectifying the anomaly that some of the largest pools of wealth in the Province escape succession duty.

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Special acknowledgment

Report of the late Dr. Kenneth A. Eaton to the Smith Committee

Report of the Wills and Trusts Section and Joint Committee of the
Taxation Section, Canadian Bar Association to the Smith Committee

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Succession Duties report :

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